

REVIEW OF U.S. INTERNATIONAL AVIATION POLICY AND BILATERAL AGREEMENTS

(102-7)

HEARINGS BEFORE THE SUBCOMMITTEE ON AVIATION OF THE COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION HOUSE OF REPRESENTATIVES ONE HUNDRED SECOND CONGRESS FIRST SESSION

MARCH 19, 21; MAY 9, 1991

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Committee on Public Works and Transportation

Congress of the United States

House of Representatives

Room 2165, Rayburn House Office Building

Washington, DC 20515

TELEPHONE AREA CODE 202, 225-4472

March 15, 1991

To: Members of the Subcommittee on Aviation
From: Committee Aviation Staff
Re: **SUMMARY OF SUBJECT MATTER** for hearing on the **REVIEW OF
U.S. INTERNATIONAL AVIATION POLICY AND BILATERAL AGREEMENTS**
Tuesday, March 19 and Thursday, March 21, 1991

The hearing continues a comprehensive review of U.S. international civil aviation policy and bilateral negotiations, which began with a hearing on October 11, 1990 (Committee Publication 101-78).

The International Civil Aviation Framework

Since World War II and the 1944 Chicago Convention on International Civil Aviation, civil aviation relationships have largely been governed by bilateral agreements between governments. It was decided then that issues of how much air service, by how many airlines, and under what pricing and marketing arrangements would be negotiated and resolved through government-to-government bilateral agreements. The Chicago Convention is a relatively unique agreement in that most other sectors of the global economy do not operate under such a regime of industry specific detailed government agreements.

The U.S. has entered into 72 bilateral civil aviation agreements with other countries. There are some instances of multinational arrangements, but these are very limited and specific such as an agreement encompassing the three Scandinavian countries. As the European Community moves toward its 1992 economic integration, the U.S. may eventually negotiate

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multilaterally with the European Community, but for the near future, the bilateral approach will continue to be the mechanism by which aviation issues between nations are resolved.

One important aspect of the bilateral system, at least from the U.S. standpoint, is that the rights and benefits exchanged through these bilaterals are limited to civil aviation matters. Other sectors hardly ever enter the picture. In other words, fishing rights are not exchanged for aircraft landing rights; landing rights are exchanged for landing rights or other aviation opportunities.

Bilateral civil air negotiations between the U.S. and its major civil aviation partners take place with relative frequency. Talks to resolve issues and problems can take place three or four times a year with countries such as the United Kingdom or Japan. Talks between the U.S. and smaller partners may occur once a year or less frequently.

U.S. civil aviation negotiation teams are typically composed of representatives from the Departments of State and Transportation. The State Department usually leads the negotiations with the Department of Transportation providing the policy guidance.

Negotiations are usually prompted by the wish of the airlines of either or both countries to expand or change service, fly to a new city, or make changes in fares. But talks also take place to resolve disputes and problems involving "doing business" issues, which are the more mundane, but often very important, aspects of the air transportation business. These include the handling of aircraft on the ground in a foreign country, how tickets will be marketed and sold, customs regulations on cargo, currency transactions, landing fees, and the availability of adequate airport space to conduct operations. Also, access of U.S. airline computer reservation systems to foreign markets has become a major topic in some civil air talks, particularly with European and Asian governments.

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Bilateral agreements typically provide formal mechanisms to resolve disputes, complaints and problems when negotiations fail. Also, the International Air Transportation Competition Act and the Fair Competitive Practices Act provide procedures whereby anti-competitive practices of foreign carriers or foreign governments are investigated by the U.S. Department of Transportation with follow up action by the DOT within specified periods of time.

U.S. International Aviation Policy

Since the late 1970s, the policy and approach of the U.S. Government with respect to civil air relations has been to negotiate bilateral civil air agreement that seek to establish a framework in which the airlines can provide services with a minimum of U.S. and foreign government approvals, interference, and restrictions. The pro-competition policies of the U.S. Government became law in 1980 upon enactment of the International Air Transportation Competition Act.

A major cornerstone of U.S. policy since the Carter Administration has been to encourage competition and low fares by removing governments, both U.S. and foreign, from decision-making on what airline fares in particular markets should be. When this type of arrangement has been agreed upon, discount fares in these markets have usually become more prevalent. In the absence of this type of arrangement, fares are often higher because foreign governments have often wanted to keep their countries' airlines protected from price competition.

The U.S. pro-competitive approach to civil air relations has met with varying degrees of success from country to country, but there are only a handful of bilateral agreements with our major aviation partners that could be described as truly competitive arrangements. Though relatively good price competition has developed between the U.S. and some European countries,

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the rest of the world remains quite regulated with respect to fares, causing fares to be relatively high.

Though a pro-competitive approach remains the broad goal of U.S. policy, in recent years U.S. civil aviation negotiators have placed increasing emphasis on ensuring that balanced deals are achieved when new route rights are exchanged and on resolving the ubiquitous "doing business" problems afflicting U.S. airlines in many foreign countries.

Early last year, DOT policy makers sought to reinvigorate the pro-competitive approach to international aviation. The U.S. Government proposed to the United Kingdom, France and Germany that "open skies" be declared between the U.S. and these countries. The U.S. proposed unrestricted rights or routes between these countries and the U.S., with pricing and scheduling governed only by market forces. The three countries have not taken the U.S. up on the proposal; however as part of agreement reached on March 11 on United and American succeeding Pan Am and TWA at Heathrow Airport in England, the U.K. has agreed to talks later this year to attempt to liberalize the U.S.-U.K. agreement.

U.S. aviation policy makers are also considering the need to start negotiating multilaterally, particularly with Europe, in order that the full market potential of the world's aviation system can be exploited. U.S. policy makers believe that the bilateral framework is constricting air carriers' abilities to provide all the service the traveling public needs and is demanding. They believe that a regional or multilateral approach could better serve the needs of the traveling public and air carriers by removing barriers and restrictions that exist in the bilateral system.

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Typical of the barriers under the bilateral system are limits on the number of carriers that can serve a market, the number and timing of flights, and the ability of carriers to serve markets beyond the gateway. By eliminating these barriers, the government framework would be brought in line with the market realities of the increasingly global aviation system. United States officials have initiated informal discussions with the aviation staff of the European Commission, but the authority of the Commission is not clear at this point.

In a further effort to move towards a more open and liberal international aviation system, the DOT announced early last year a new policy of permitting, in specified circumstances, foreign carriers to serve U.S. points without obtaining the rights through a traditional bilateral negotiation. Such rights will be granted when a foreign carrier seeks to start scheduled service between its country and a U.S. point and no other airline is providing service in that market, and the bilateral agreement is competitive, liberal, and free of disputes. Netherlands-Baltimore service by KLM, Switzerland-Philadelphia service by Swissair, Chile-Washington service by Ladeco, Frankfurt-Charlotte service by Lufthansa and Amsterdam-Minneapolis service by KLM have been approved under this arrangement. Observers expect new foreign carrier service to the U.S. to expand under this new arrangement as other U.S. cities actively solicit foreign carrier service.

Finally, the U.S. will begin talks with Canada in early April to develop an "open skies" arrangement between the two countries. Should these talks succeed, they could establish a model for future open skies arrangements with other countries.

Foreign Ownership and Cabotage

Two fundamental legal principles governing U.S. international aviation policy should be noted because these legal principles will increasingly be the subject of discussion and debate over aviation policy.

First, there have been recent policy initiatives and interpretations on foreign ownership and control that could have significant implications for aviation relations with other countries.

The Federal Aviation Act imposes specific limitations on foreign ownership of United States' airlines. Under the Federal Aviation Act, a United States air carrier must have at least 75% of its "voting interest" owned or controlled by persons who are citizens of the United States, and the President of the airline and at least 2/3 of the Board of Directors and other managing officers of the company must be United States citizens. In addition to these specific requirements, the Civil Aeronautics Board and its successor, the Department of Transportation, have interpreted the law as requiring that citizens of the United States must be in actual control of the airline. In implementing this requirement, DOT determines "...whether a foreign interest may be in a position to exercise actual control over the airline, i.e. whether it will have a substantial ability to influence the carriers activities." If so, the airline cannot obtain a certificate as a United States air carrier.

The leading recent case in which the Department refused to find an airline in compliance with the U.S. ownership requirement, even though the airline had complied with the specific requirements of the Federal Aviation Act, was the case of KLM and Northwest Airlines, decided in 1989. In that case, KLM, a Dutch airline, was found to have the power to exercise control over Northwest when: a) although KLM owned less than 5% of the voting stock of Northwest (the law prohibits ownership of more than 25% of the voting stock) KLM held substantial non-voting stock, giving it ownership of 57% of Northwest's total equity, and b) KLM had the right to name one of twelve Northwest directors and a three person committee to advise on the general management of Northwest's financial affairs. In a consent order, DOT directed that KLM's equity interest in Northwest be reduced to not more than 25% of the total equity; that the KLM general advisory committee be dissolved; and that there be restrictions on the actions taken by the KLM representative on the Northwest board.

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Following the original Northwest order, DOT granted several extensions of time for the divestiture of KLM's interest in Northwest. Then on January 23, 1991, the Department granted Northwest's motion for modifications to the original order. Under these modifications, DOT will permit KLM to hold up to 49% of the total equity interest in Northwest including up to 25% of the voting stock. KLM is also allowed to hold stock in excess of 49% if it places this stock in a voting trust. In addition, Northwest is authorized to increase its Board of Directors from 12 to 15, and KLM is allowed to have three representatives on this Board. The DOT order further indicates that DOT will not allow a foreign citizen to hold the position of Chairman of the Board of Northwest, and foreign citizens will not be permitted to hold a disproportionate number of seats on important Committees of the Board.

In its order allowing these modifications, DOT announced that it had developed a new general policy on foreign control. The Department stated that:

"While the facts of each case would have to be reviewed in their entirety, as a general matter we would not construe foreign equity investment up to these limits (less than 50% of total equity and 25% of voting equity), taken alone, as indicative of foreign control."

On the related question of foreign debt in U.S. air carriers, the Department stated that "absent a default, unless the loan agreement provides special rights to the debt holder that imply control, we do not anticipate treating debt as a foreign control issue."

The KLM order states that the change in DOT policy is based on a reassessment of what constitutes control. The reason given for this reassessment was that in the course of evaluating proposals for air carriers to obtain from foreign sources, the Department had:

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"...seen the complexity and international make up of these arrangements increase, new financial instruments emerge, and the inter-relationship of these instruments grow. Based on that experience, we have reexamined our application of the control test in order to reflect more accurately today's complex global corporate and financial environment, consistent with the requirement for U.S. citizen control."

Finally, with regard to the issues surrounding foreign ownership of U.S. airlines, Congressman Clinger recently introduced a bill (H.R.782) which would increase the percentage of the voting stock of a United States airline which could be owned by foreign interests. The Clinger bill would permit the Secretary of Transportation to authorize foreign interests to hold up to 49% of the voting stock of a U.S. carrier, compared to the existing statutory limit of 25%, if the Secretary found that:

- 1) the U.S. had pro-competitive agreement with the country of which the foreign owner was a citizen;
- 2) the laws of the foreign country involved would permit U.S. citizens to acquire the same percentage of voting stock of carriers of that country;
- 3) the chief executive officer and at least 2/3 of the directors of the U.S. carrier would be U.S. citizens;
- 4) the foreign stock ownership would be consistent with the national security interests of the U.S. and otherwise in the public interest.

A second fundamental legal principle governing U.S. international aviation policy is that all nations, including the U.S., prohibit what is termed 'cabotage,' a centuries old concept originating in the maritime sector. Cabotage is the carriage of passengers and goods between two domestic points by a foreign carrier. All nations have reserved for their domestic carriers, for reasons ranging from national security to protection of domestic industries, the right to carry domestic traffic.

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However, cabotage is increasingly being discussed in the international aviation community. From time to time in recent years, foreign governments have expressed an interest in exchanging cabotage rights with the U.S. Also, the U.S. Government has recently been presented with ownership and marketing arrangements between U.S. and foreign carriers that have raised questions of whether the arrangements' practical effect amounted to cabotage.

The U.S. Government's policy to date has been to oppose cabotage within the United States because U.S. domestic markets are disproportionately large compared to other countries' domestic markets. There is nothing of equal value in any foreign country's domestic market to the large U.S. domestic markets, hence no trade of bilateral cabotage rights has been worth entering into from the U.S. perspective. The largest domestic markets within the United Kingdom, for example, pale next to the large U.S. domestic markets in both size and revenues. However, limited forms of cabotage for foreign carriers are increasingly being considered particularly in the case of Canada. Integration of the European Economic Community may also challenge the cabotage principle.

Passenger Travel Between the U.S. and Other Countries

In 1989, approximately 73 million passengers traveled between the United States and other countries. Data for 1990 are preliminary, but international traffic climbed at a rate of 10% for the 12 months ending October 31, 1990. This rate of growth would mean approximately 82 million passengers traveled between the U.S. and other countries in 1990. International boardings account for 8% of the total boardings on U.S. airlines.

International passenger traffic between the U.S. and the rest of the world has enjoyed strong and healthy growth since the late 1970s. Since 1976, when approximately 33 million airline passengers flew between the U.S. and other countries, traffic has grown two and a half times. In some regions, the traffic growth has been even more pronounced. Travel between the

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U.S. and the Far East has climbed from approximately 3 million passengers in 1976 to approximately 12.6 million last year, over a four fold increase.

Until 1988, the U.S. carriers' international market share was historically in the 48-49% range. In 1988, U.S. market share climbed to 52%; held there in 1989; and in 1990 climbed to 53%. Not only has the international passenger market expanded, but so has the U.S. carrier share of it. For some of the larger markets, U.S. market share is higher.

Of the 73 million traveling between the U.S. and other countries in 1989, 56% were U.S. citizens. The vast preponderance of international travelers (95%) use scheduled flights while only 5% fly charter services.

The following table provides passenger traffic data for the U.S. international markets that had more than one million passengers in the year ending September 30, 1990.

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Passenger Travel Between the U.S. and Other Countries

(Year Ending September 30, 1990)

<u>Country</u>	<u>Passenger Traffic in Millions</u>	<u>% U.S. Citizens</u>	<u>% on U.S. Flag Airlines</u>
Canada	12.0	N/A	66
United Kingdom	10.0	50	51
Japan	8.8	23	58
Mexico	8.3	71	53
Germany-West	4.7	59	51
France	3.4	56	65
Bahama Islands	3.0	75	70
Dominican Republic	1.9	76	83
Jamaica	1.8	73	48
Netherlands	1.6	52	19
Italy	1.5	62	54
Korea-South	1.5	51	46
Netherland Antilles	1.2	81	78
Switzerland	1.2	56	30
Scandinavia	1.2	41	40
Brazil	1.1	33	46
Spain	1.1	57	54
Australia	1.0	41	59

Committee staff has data for other countries for those who are interested.

The Federal Aviation Administration forecasts that international passenger enplanements will grow at an average annual rate of 5.9% for the balance of the century which would put total travelers between the U.S. and other countries at approximately 145-150 million at the turn of the century. The rate of forecasted growth varies considerably among world regions. While traffic between the U.S. and Europe and Latin America is expected to grow annually at 4.7% and 4.9% respectively, travel between the U.S. and Pacific countries is anticipated to grow an average of 8.6% annually. It should be noted that this forecast was made taking account of the effects of the Persian Gulf War on airline travel.

It should be further noted that the accuracy of long range forecasting of international air traffic patterns and growth is often problematic. For example, in recent years, traffic growth, particularly in the Pacific, has exceeded expectations. On the other hand, international events, particularly terrorist activity, can seriously dampen international traffic very quickly and unexpectedly, as was the case in 1986. The Iraq invasion of Kuwait last August did slow international travel growth generally toward the end of last year, and the allied offensive in January and February accompanied by fears of terrorist acts combined to actually reduce international travel in those months approximately 15-20% compared to the same period one year ago. Now that hostilities have ceased, normal traffic patterns are expected to slowly resume.

U.S. International Airline Finances

Finances for 1990 international air carrier operations, particularly in the latter half of the year, were in a state of turmoil due to the Persian Gulf situation and the spiking of fuel costs during the Fall. Data for 1990 has not been totally reported and analyzed yet, but substantial losses for international operations are anticipated across the board. 1990 revenues rose, but the growth in expenses outpaced these revenues. Most analysts believe 1991 will be a better year financially.

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In 1989, the U.S. airlines received \$13.6 billion in revenues from providing international services, not including services to Canada (U.S. carrier revenues for Canadian services were \$1.8 billion). Total international operating expenses were \$13.7 billion outside of Canadian service for a net operating loss of \$71.8 million in 1989. 1988 was a much better year for U.S. international operations. In that year, over \$825 million was earned on \$11.4 billion of revenue.

1989's poor performance can be attributed to start-up costs of new services by a number of carriers, expansion of capacity in some markets, softening of traffic growth, and financial hemorrhaging by Pan Am and Eastern. Even so, this 1989 marginal loss does not reflect the international airline business picture in a uniform way. There were significant profit and loss centers within the international system for U.S. carriers.

The following table provides financial data for U.S. international airlines by world region.

Summary of U.S. Airline International Revenues and Expenses (passenger and cargo)

1989
(in \$ millions)

Routes	Operating Revenues	Operating Expenses	Operating Profit/(Loss)
Atlantic	\$ 5,937	\$ 6,270	(333)
Pacific	5,799	5,426	353
Latin	1,910	2,001	(91)
Canada*	1,840	n/a	n/a
TOTAL:	\$13,626	\$13,697	(72)

*Canada data is not included in the total, as there is no corresponding expenses or profit loss data.

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As the table indicates, the Pacific routes were profitable in 1989, while Atlantic and Latin routes were unprofitable. This is why there is intense interest by most major U.S. carriers in expanding or breaking into the Pacific markets, particularly Japan. The Asian market is expanding more rapidly than other regions, and yields are relatively high due to the restrictive pricing regimes of the bilateral agreements.

The following table depicts the relative size of U.S. international airlines' operations and the relative importance of different world regions to each carrier's operations.

U.S. Airline Revenues by World Regions
(passenger and cargo)

Airline	1989 (in \$ millions)			
	Total International	Atlantic	Pacific	Latin
Pan Am	\$ 2,655	\$1,920	—	\$ 735
Northwest	2,610	380	\$2,310	—
United	2,179	—	2,179	—
TWA	1,590	1,590	—	—
American	1,291	721	106	464
Federal Express	1,084	671	414	—
Continental	1,048	236	225	588
Delta*	868	462	191	216
Eastern*	257	—	—	257
USAir	44	30	—	14
TOTAL:	\$13,626	\$5,937	\$5,779	\$1,910

*Eastern's Latin American route system was transferred to American Airlines on May 3, 1990.

International Air Cargo

The shipment of air cargo or freight has increased significantly in its importance within the U.S. international aviation sector. In 1989, U.S. carrier international freight revenues were approximately \$2 billion. The amount of international air freight flown by U.S. carriers as measured by revenue ton miles has approximately tripled since 1980. U.S. market share of the movement of freight between the U.S. and other countries has declined markedly since the mid-1970s from 42% to approximately 30%. An April 1988 Analysis of the United States International Air Cargo Market by the U.S. DOT and State Department concluded that this decline was due to countries with fast growing economies pursuing policies of aggressive development of air freight services.

In May 1989, the DOT issued a Statement of U.S. International Air Cargo Policy intended to guide U.S. aviation negotiators. The Statement called for specific treatment of cargo issues in aviation negotiations and for comparability of air cargo opportunities between U.S. and foreign carriers.

The policy statement grew out of hearings in the late 1980s by the Subcommittee on Investigations and Oversight that revealed that not enough attention and emphasis was being placed on the cargo side of international air transportation by U.S. policy-makers and negotiators. This lack of emphasis resulted in quality and cost of service problems for the shipping public and competitive disadvantages for U.S. carriers.

The following table provides a summary of U.S. carriers' international freight revenues for 1989 and the relative importance of the different world regions to each carriers' freight operations. Data for 1990 has not been fully developed yet, but air cargo traffic growth in 1990 over 1989 was generally flat due to the world economic slowdown.

U.S. Airline International Cargo Revenues
1989
(in \$ millions)

<u>Airline</u>	<u>Total</u>	<u>Pacific</u>	<u>Atlantic</u>	<u>Latin</u>
Federal Express	\$959	\$370	\$589	—
Northwest	358	334	24	—
United	188	188	—	—
Pan Am	164	—	115	\$49
TWA	93	—	93	—
Delta	87	41	39	7
American	85	7	56	21
Continental	74	51	19	4
Eastern*	12	—	—	12
USAir	1	—	—	—
TOTAL:	\$2,021	\$991	\$935	\$93

*Eastern's Latin American route system was transferred to American Airlines on May 3, 1990.

Status of Relations with Major Aviation Partners

The following provides a brief description of the aviation relationship between the U.S. and its largest aviation partners.

Canada

Canada is the United States' largest aviation partner. Though it is the largest, analysts believe that there is great amount of unfulfilled demand for air travel between the two countries because the bilateral agreement is highly restrictive. Routes and services are quite limited, and all pricing decisions must meet government approval. Negotiations to expand the

number of routes and liberalize the relationship have taken place for years with only small progress being made, due to Canadian concerns over its small carriers' ability to compete with the large U.S. carriers in a liberal environment.

It now appears that both Canada and the U.S. are very much interested in initiating negotiations to liberalize the relationship. Announcements last fall about liberalizing the relationship by DOT Secretary Skinner and his Canadian counterpart Transport Minister Lewis have given this negotiating initiative high visibility. Talks will begin in early April and are expected to take 1-2 years to conclude. Canada is likely to bring some form of cabotage for Canadian carriers within the U.S. to the table. If cabotage were agreed to, Congress would need to pass legislation to implement an agreement.

Last December, Aviation Subcommittee Chairman Oberstar led a delegation of Subcommittee Members to Ottawa. The Delegation met with Members of the Canadian Parliament, Transport Minister Lewis, other Canadian Government officials, and representatives of the Canadian aviation industry and labor organizations to gain a better understanding of the Canadian perspective on the future of the aviation relationship between the U.S. and Canada.

United Kingdom

The U.S.-British aviation relationship has been a quite stormy one for years. In 1976, the U.S. and the U.K. came very close to ceasing air service between the two countries over a dispute on drawing up a new bilateral agreement. British Airways is no longer owned by the British Government, but the government continues to go to great lengths to protect British Airways' position in the marketplace. The agreement is a traditional, conservative one, but in practice there is a relatively high level of competition in fares and services between the two countries.

Negotiations have taken place over the past several weeks to determine under what terms United and American will succeed Pan American and TWA at London's Heathrow Airport. These talks were concluded on March 11. The previous agreement did not permit the U.S. Government to replace the two incumbent carriers without British agreement. The U.S. will now replace Pan American and TWA at Heathrow with United and American. The U.K. received in return substantial new operating authority to and beyond the U.S. The package provides that U.K. carriers will be able to operate from continental European points directly to the U.S. (provided other European governments agree) and beyond the U.S. to new points in Latin America, Asia, and Australia. Also, a second U.K. carrier will be able to operate from Heathrow to the U.S. British carriers also obtained the right to code-share with U.S. carriers, enabling U.S. flights that connect with British carrier flights to be displayed as on-line British flights in computer reservation systems. The two countries also agreed to negotiate later this year further to attempt to liberalize the aviation relationship.

Another issue that has festered for years is the landing fees charged to U.S. carriers at London/Heathrow Airport. The U.S. Government believes the high fees are discriminatory against the U.S. carriers. The U.S. and the U.K. governments are now engaged in arbitration at the World Court over this issue.

Another outstanding issue is a complaint filed with the DOT by American Airlines against the British Airport Authority. American does not have the ability to provide ground services for itself at Gatwick Airport and wants to do so. DOT believes progress is being made to resolve this complaint.

An earlier agreement was reached last year to provide two new routes between the U.S. and Manchester. Several U.S. carriers are seeking those routes through an ongoing DOT

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proceeding. The British were awarded two new routes as well from secondary British points to the U.S.

Japan

In 1989, the U.S. and Japan reached an agreement permitting a significant expansion of service between the two countries. Under the agreement, each country designated for its carriers three new passengers routes between the U.S. and Tokyo, three new passenger routes between the U.S. and a Japanese point other than Tokyo, a new cargo route, and 450 charter flights per year.

The U.S. has designated UPS for the cargo route, but UPS last Fall had difficulty in securing the landing slots it needed at Tokyo to provide the service. Until the issue was resolved in February, the U.S. Government did not permit the Japanese cargo carrier to initiate its new service at Chicago. Both carriers are now expected to inaugurate services in the next few weeks.

Last October the U.S. government designated the following route authority pursuant to the new agreement: Chicago/Tokyo - United; Los Angeles/Tokyo - Delta; San Jose/Tokyo - American; Honolulu/Nagoya - America West; Honolulu/Fukouka - Hawaiian; and Portland/Nagoya - Delta.

The U.S.-Japan bilateral is a traditional, restrictive agreement. The U.S. would like to see a much more competitive environment established, but the Japanese have no interest in this as they are fearful that the large U.S. carriers would further expand their market share. There is also no U.S. airline constituency for a truly competitive regime with Japan as fares in these markets are some of the highest yielding in the world.

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The Japanese also want a new bilateral but for wholly different reasons than the U.S. They view the current agreement as a product of post-World War II occupation and as very unfair to the Japanese. The Japanese point to the fact that while only 24% of the traffic are U.S. citizens, U.S. airlines carry 55% of the traffic. The Japanese feel that the bilateral should be changed to reflect a more equitable distribution of the traffic, meaning, from their standpoint, that U.S. rights would be cut back.

Because the U.S. and Japan are philosophically polarized on aviation issues, the current bilateral is likely to remain in place for the foreseeable future, and periodically, incremental expansions of services will be made.

Mexico

In 1988, the Mexican Government made a fundamental change in its approach to its civil aviation relationship with the U.S. by deciding to aggressively promote and attract tourism. To accomplish this, the Mexicans are permitting a large expansion of new route authority for U.S. carriers. In some cases, multiple U.S. designations over the same route are being permitted. Prior to this policy change, Mexico took a more traditional approach of sheltering its national carriers from competitive forces. U.S. airlines are expanding their service to Mexico.

Germany

The U.S. and Germany have a relatively liberal and competitive relationship. Though pricing is relatively competitive and open, the U.S. would like to make it more so. Germany retains authority to pass judgement on fares out of Germany and has been disapproving some low fare initiatives by U.S. carriers.

The unification of West and East Germany resulted in Pan Am selling its rights to provide inter-German Berlin Services to Lufthansa for \$150 million. Prior to unification, Berlin air services had been largely regulated by the former World War II Allies with Lufthansa not being permitted to serve Berlin. Reunification destroyed the rationale for this arrangement.

France

The U.S. and France also have established a relatively liberal aviation environment operating between the two countries; however, a perennial issue between the two countries is France's desire to limit capacity increases by U.S. carriers. An agreement reached last Summer required the U.S. to state what the capacity expansion plans of U.S. carriers would be for the next two years. Expansion will be limited to that capacity, which largely reflects what U.S. carriers want to fly during that period. The arrangement has been working to the satisfaction of the U.S. since that time.

This recent agreement also provided for new Chicago/Paris route authority beginning this coming Summer and Dulles-Washington/Paris authority for United Airlines beginning in the Summer of 1992. United very much wanted to commence the Dulles service sooner. The agreement also provided that cargo carriers would have the right to carry cargo originating in France beyond to other points on flights that originated in the U.S.

International Aviation Issues of the 1990s

Outside of the "routine" international aviation issues, U.S. policy makers will soon be confronted with a number of very important developments with very significant policy implications.

European Community Integration- The European community plans to integrate its economies beginning in 1992 by reducing barriers to flow of goods, people, and money across borders. Integration presumably will include a liberalization of civil aviation relations within Europe. A major issue for the U.S. is to what extent the liberalization will spill over to relations with non-European countries. There are concerns that European integration could result in a loss of rights for the U.S. within Europe, unless the U.S. is prepared to permit some cabotage within the U.S. for European carriers. There has been considerable speculation that after 1992, intra-European routes could be considered cabotage for non-European carriers. There is also uncertainty as to who the U.S. will negotiate with after integration, individual countries or representatives of the multilateral community. Among U.S. airlines, there is a sense that it is very important to obtain as many European rights as possible before 1992, given the uncertainty of the U.S.-Europe relationship post 1992.

Transborder Ownership of International Carriers : Over the past few years there has been increasing interest by carriers, both U.S. and foreign, in investing in carriers of other countries. Most governments place restrictions and limitations on foreign investment in airlines of their countries. The U.S. Government's policy, while not undergoing any statutory change, has gone through significant policy reinterpretations over the past year and a half (described earlier).

Most industry analysts anticipate that the airlines will increasingly expand the scope of their international operations and increasingly enter into investment relationships with each other in order to expand and protect markets. There will be increasing interest by carriers in generally relaxing foreign ownership restrictions.

The Adequacy of Aviation Infrastructure Abroad : Growth of civil aviation is not only outpacing the U.S. infrastructure but Europe's and Asia's as well. In fact, aviation infrastructure problems are far more acute in Europe and Japan than in the U.S. As service expansions are

negotiated, policy makers will have to be increasingly cognizant of access and infrastructure problems that may negate or diminish the benefits of new negotiated service rights. On the bright side, there are a number of significant new airport projects underway in Asia that will improve the capacity situation in that part of the world later this decade.

Implications of Financial Problems of Some U.S. Airlines : Two of the United States' international airlines, Pan American and TWA, are in deep financial difficulty (Pan American is in Chapter 11 bankruptcy). Already, these two carriers are selling their London and other routes to United and American. These route sales, will significantly alter the market shares of U.S. carriers flying trans-Atlantic routes. If these carriers continue to sell routes or liquidate their operations, strong U.S. carriers can be further expected to move into these routes. To the extent this happens, civil air relations between the U.S. and Europe will have to contend with an increasing presence of stronger U.S. carriers in the U.S.-European market.

General Agreement on Trade in Services Negotiations : The Uruguay Round of trade talks failed to reach an agreement last year. However, the President is proposing that the talks be resumed and that the Congressional fast-track agreement approval process be extended for the two years. Last year, there was considerable debate and discussion over whether some aspects of international airline services should be included in a General Agreement on Trade and Tariffs framework. Depending on to what degree aviation services were to be included in an agreement, the scope of bilateral civil aviation agreements and negotiations could be significantly lessened. The Committee held hearings in November 1989 (Committee Publication 101-23) on the implications of airline services in a G.A.T.T. type arrangement. Also last year, the Committee leadership introduced H.Con.Res 280 urging that international air service be excluded from a G.A.T.T. Trade in Services Agreement, believing it would weaken the generally strong U.S. negotiating position in civil aviation matters and result in protracted resolution of disputes that

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are able to be resolved relatively quickly bilaterally. If the Uruguay Round is reopened, whether airline services would be covered would continue to be debated.

Anticipated Witnesses

Representatives from the following organizations are expected to present testimony:

- o U.S. Department of Transportation
- o Air Transport Association
- o Airport Operators Council International
- o National Air Carrier Association
- o Air Line Pilots Association
- o Allied Pilots Association
- o U.S. Airports for Better International Air Service
- o United Airlines
- o Pan American World Airways
- o Alaska Airlines
- o Harbridge House

REVIEW OF U.S. INTERNATIONAL AVIATION POLICY AND BILATERAL AGREEMENTS

TUESDAY, MARCH 19, 1991

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON AVIATION,
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:00 a.m. in room 2253, Rayburn House Office Building, Hon. James L. Oberstar (chairman of the subcommittee) presiding.

Mr. OBERSTAR. The Subcommittee on Aviation will please come to order. This morning we continue the process begun a few weeks ago and continued over the past several years of comprehensively reviewing the U.S. International Aviation Policy, and this morning specifically reviewing our bilateral agreements.

In the hearings held last October we heard from Assistant Secretary of Transportation Jeffrey N. Shane. We have him back this morning as a witness. Since last October some very significant policy changes have occurred, ones that were not anticipated and were not discussed or explored in the course of that hearing. They focus and raise concerns in the area of foreign ownership and foreign investment in U.S. carriers.

Also, the collateral matter of sales of international routes and negotiations with our bilateral partners who in at least one case have exacted from the United States payment that seems excessive and which we should review this morning in the course of this hearing.

Earlier this year we explored the problems of the financial condition of the airline industry and touched briefly on the matter of foreign ownership of U.S. airlines and the recent policy changes DOT has initiated.

This week we would like to see how those changes fit into overall international aviation trade policy and our relations with major trading partners.

Not only have there been significant changes since last October in the policy framework, but some very important developments in the international airline industry and in competition.

For the United States, Pan Am, for many years the symbol of the United States, is in bankruptcy. The second largest carrier in Europe, TWA, has defaulted on some of its obligations. Both carriers are seeking to sell valuable international routes to American and United Airlines in order to survive.

We are beginning to see again the process of dismemberment of a major carrier, to the benefit of other competitors as the number of U.S. carriers in the domestic and international trade begins to shrink.

For those route sales to be consummated, the United States entered into a rather far-reaching agreement with the United Kingdom just a week ago in which British carriers received substantial new operating rights to and beyond the United States.

Depending on your perspective within the U.S. airline industry, you may either be a modern Paul Revere shouting with alarm, "the British are coming," or you may be smugly humming, God save the Queen.

In a couple of weeks we will see continued negotiations and very important ones with our neighbors to the north. Relations with the U.S. and Canada are in need of overhaul. This subcommittee spent three very productive days in December in Ottawa meeting with our counterparts with members of the Canadian Parliament; with the Minister of Transport, Mr. Lewis; with representatives of airline industry and labor; and with communities interested in broadening trade with the United States. We developed a very good understanding of the opportunities as well as the obstacles for increased, expanded or liberalized, if you will, trade between U.S. and Canada.

I think we have a good opportunity here. It is also clear that most observers and participants in the U.S.-Canada trade believe that the current agreement poorly serves the traveling public of both countries. We will look forward to hearing Mr. Shane's views representing the Department of Transportation on the eve of those negotiations.

Beyond the specific bilateral talks, we want to explore some of the "doing business" problems which we will hear from industry representatives. We would like to look further beyond these agreements, beyond this week to the scene in international aviation trade two to five years hence, particularly in light of what is happening in Europe as the European common market moves inexorably toward a single internal market and the far-reaching consequences that will have for U.S. aviation trade.

This is not the end of a process; it is not the beginning of a process. It is the continuation of this committee's long-standing interest and concern in maintaining one of the unique relationships we have in international trade, an opportunity to negotiate rights for rights, values for values, and give U.S. commercial interests a fair opportunity to compete with the creative ingenuity that American industry has in international aviation trade.

The gentleman from Pennsylvania, Mr. Clinger.

Mr. CLINGER. Thank you, Mr. Chairman.

American air carriers have responded to changes brought about by deregulation in a truly unprecedented fashion. By dint of aggressive and innovative marketing and by wagering huge investments in new equipment and facilities, they have been able to attract a growing, and indeed, an exponentially growing number of U.S. citizens to travel to domestic and overseas destinations.

Jet manufacturers put at risk huge sums of money to design and develop a new generation of aircraft capable of traveling extraordi-

nary distances. These planes now permit non-stop service from points in the interior U.S. to the far Pacific markets and to Europe.

The efficiencies of these aircraft permit profitable operations on long thin routes.

The advent of hubs has created a large number of new gateway cities that until recently were confined to several points on the east or west coast. Hubs not only allow for convenient and cost efficient service from interior cities, they also present foreign carriers with new opportunities to carry traffic into our own borders.

Air carriers rely more and more on international routes to develop and feed traffic from the growing number of hubs. Indeed, with the saturation of our domestic markets, international routes present the greatest potential for growth and profitability.

As our country and our economy become more and more interdependent with foreign businesses, I think it is inevitable that air carriers are going to become globalized. That process is under way and I think will continue. We are already seeing code sharing among U.S. and foreign flag carriers, cross-investments, and a greater interest to cooperate on cross-feeding passengers at international gateways.

I believe we have entered a new era of international business relationships, but one that presents a tremendous number of challenges. There continue to be considerable differences in size and ownership, domestic markets, and scope of operations among competing U.S. and international carriers. Attempting to establish a level playing field to protect our own carriers, while foreign governments seek similar protections, will test the most creative negotiators.

In keeping with the spirit of globalization, I believe we must also address the issue of foreign investment in U.S. carriers. It is no secret that several major U.S. carriers are suffering dire financial straits. The cause can be contributed to several factors, but the fact is that these carriers have limited access to capital markets and some, indeed, have no access at all to capital markets.

Is it in the best interest that we should preclude these carriers from approaching foreign investors? I think not.

As you know, Mr. Chairman, I have introduced legislation that would liberalize present investment restrictions allowing foreign ownership of up to 49 percent of a carrier's voting stock. A number of significant conditions are attached restricting investors to those countries that allow reciprocal rights for U.S. investors and to those countries having procompetitive bilaterals with the United States.

Finally, the bill gives the Secretary of Transportation general veto authority in the event he determines an investor stake is not consistent with U.S. public policy.

Some have argued that allowing foreigners to purchase a major stake in U.S. carriers is unsound. I disagree. However you wish to characterize the essential services provided by carriers, I believe their value to the U.S., whether speaking about security or economic consideration, is no different than the automotive or the computer industries, and these two industries are not limited by Federal law as to foreign investment.

The health of our present intensely competitive domestic, air carrier industry and our carrier's ability to compete now and in the future in international markets demands that they have access to capital markets that is presently not available to them.

Whether you agree with airline deregulation or not, I think we must take prudent steps to preserve the remaining carriers. Further consolidation will jeopardize the gains we have enjoyed during the 1980s which will certainly undermine competition at home and abroad and result in an even weaker industry than we have today.

Thank you, very much.

Mr. OBERSTAR. Thank you, Mr. Clinger.

The Chairman of our full committee, Mr. Roe, has joined us for this hearing as he has for all the other activities that we have engaged in the subcommittee. We welcome the Chairman and his vigor and interest and his breadth of viewpoint.

The CHAIRMAN. I thank you, Mr. Chairman. I want to compliment you, particularly, and Bill Clinger for holding this hearing. I noted that you described it in your statement as a continuation of previous hearings. I know that you have been vigorously pursuing this for the last year at least. I agree as you pointed out in your opening statement, that a lot has happened in the last few weeks and months.

I would like to raise some concerns that I hope the Committee would look into as we proceed. I think the Heathrow Agreement is a landmark agreement to say the least because it starts to open up and change dimensions so as far as our domestic airlines are involved.

I am also concerned about how far we go in some of these areas without some in-depth agreements with foreign governments, particularly with regard to subsidization of the airlines. How do foreign government subsidy of their carriers relate to competitiveness when in our country, we are playing with a different set of rules? I think that ought to be examined.

I think the point that both you and Mr. Clinger have made is absolutely on target. We are dealing in a global economy. It is no longer a valid point of view that we have an internal United States market or European market or a Far Eastern market. It is a global economy, and we have to deal with that.

However, I think there is a great caution to be raised here today in view of what has happened in the last three months. I think that great caution is how we proceed down the international trail and what that means to domestic ownership of United States airlines.

Another thought occurs to me. What does it mean to our aircraft production companies such as Boeing as we start to open up our marketplace who are in competition, with Airbus in Europe. I am not at all convinced that picture is clear at this station. I am not at all convinced that we should just go over the Heathrow Agreement and say it is done; so it is written, so shall it be.

I would hope, Chairman Oberstar, that you would hold a special hearing on the Heathrow Agreement because of the foundation it sets in effect for the future of our national aviation policy.

Again, I want to thank you and pay my high regards to John Paul Hammerschmidt, our Ranking Member, for his extraordinary

effort, service, and great support in the efforts that you are carrying out for the aviation industry in America.

Mr. OBERSTAR. Thank you for your observation, Mr. Chairman. We share your concern and we will focus this morning and continue to pursue that Heathrow Agreement as you suggested.

The Chair recognizes the gentleman from Arkansas, Mr. Hammerschmidt, Ranking Republican on the Full Committee.

Mr. HAMMERSCHMIDT. Thank you, Mr. Chairman. We all know that no one knows more about this subject in the House than you and Mr. Clinger and we appreciate that.

As you stated, the purpose of this hearing is to review our current policies and negotiating strategies for international air service in order to assure that U.S. interests are being adequately protected.

For this reason—our Chairman mentioned Heathrow, but I have no reason to believe that there are any serious deficiencies in this area. However, that is why we are having these hearings. It is important for us to monitor the situation in fulfillment of that important oversight role which I commend you for doing.

As you have also stated, Mr. Chairman, among the several issues to be considered that you have on the table here, is the sale of international routes. I commend you and Mr. Clinger for this important work and for this open forum where we get to hear from very knowledgeable witnesses.

Thank you very much.

[Mr. Hammerschmidt's prepared statement follows:]

HONORABLE ~~JOHN F. HAMMERSCHMIDT~~
SUBCOMMITTEE ON AVIATION
HEARING ON
INTERNATIONAL AVIATION ISSUES
ON MARCH 19, 1991
10:00 A.M. IN ROOM 2253 RAYBURN

MR. CHAIRMAN:

LAST YEAR, MORE THAN 60 MILLION PEOPLE FLEW ON INTERNATIONAL FLIGHTS FROM THE UNITED STATES. WHILE THE WAR AND RECESSION HAVE DEPRESSED TRAVEL RECENTLY, THE LONG-TERM TREND FOR INTERNATIONAL AIR TRAVEL SEEMS TO BE CONTINUED STRONG GROWTH. THIS IS MAKING INTERNATIONAL AVIATION AN INCREASINGLY IMPORTANT SEGMENT OF OUR AIR TRANSPORTATION SYSTEM.

UNLIKE DOMESTIC AVIATION, INTERNATIONAL AIR SERVICE REMAINS HEAVILY REGULATED. THIS IS LARGELY THE RESULT OF THE RESTRICTIVE POLICIES OF OTHER COUNTRIES. IN SUCH AN ENVIRONMENT, WHERE FLIGHTS AND PRICING FLEXIBILITY ARE LIMITED, IT IS IMPORTANT THAT THE INTERESTS OF U.S. CARRIERS BE VIGOROUSLY DEFENDED.

THE PURPOSE OF THIS HEARING IS TO REVIEW OUR CURRENT POLICIES AND NEGOTIATING STRATEGIES IN ORDER TO ENSURE THAT U.S. INTERESTS ARE BEING ADEQUATELY PROTECTED. AT THIS POINT, I HAVE NO REASON TO BELIEVE THAT THERE ARE ANY SERIOUS DEFICIENCIES IN THIS AREA. HOWEVER, IT IS IMPORTANT FOR US TO MONITOR THE SITUATION IN FULFILLMENT OF OUR IMPORTANT OVERSIGHT ROLE.

THERE ARE SEVERAL CONTROVERSIAL ISSUES IN INTERNATIONAL AVIATION THAT MERIT OUR CONTINUED ATTENTION. ONE INVOLVES THE SALE OF INTERNATIONAL ROUTES.

INTERNATIONAL ROUTE SALES ARE NOTHING NEW. HOWEVER, THEY HAVE PROLIFERATED LATELY. SOME FEEL THAT CARRIERS SHOULD NOT BE ABLE TO SELL WHAT ARE ESSENTIALLY PUBLIC ASSETS. OTHERS ARE CONCERNED ABOUT THE COMPETITIVE IMPLICATIONS OF THESE SALES SINCE ALL THE LUCRATIVE INTERNATIONAL ROUTES SEEM TO BE GOING TO THE AIRLINES THAT ARE ALREADY THE BIGGEST AND RICHEST. WHILE THESE AIRLINES MAY PROVIDE THE STRONGEST COMPETITION IN THE INTERNATIONAL ARENA, THE IMPLICATIONS FOR DOMESTIC COMPETITION ARE TROUBLING.

PERHAPS DOT SHOULD BE TAKING A MORE ACTIVE ROLE IN ENSURING THAT ROUTES END UP IN THE HANDS OF THOSE CARRIERS WHO CAN BEST SERVE THE PUBLIC INTEREST AND NOT MERELY THOSE WITH THE DEEPEST POCKETS.

ANOTHER CONTROVERSY INVOLVES CABOTAGE. CURRENTLY, THIS IS PROHIBITED BY THE FEDERAL AVIATION ACT. HOWEVER, IN ANNOUNCING UPCOMING NEGOTIATIONS WITH CANADA, DOT INDICATED THAT IT MAY CONSIDER OPENING UP OUR DOMESTIC AVIATION MARKET TO FOREIGN CARRIERS. THIS IS A VERY SENSITIVE ISSUE AND ONE WHERE WE SHOULD MOVE ONLY WITH GREAT CAUTION.

THERE ARE MANY OTHER IMPORTANT ISSUES IN THIS AREA WHICH I'M SURE OUR WITNESSES WILL DISCUSS. THEY ALL HAVE EXTENSIVE EXPERIENCE WITH THESE ISSUES AND WE WELCOME THEM BEFORE THE COMMITTEE TODAY.

Mr. OBERSTAR. Thank you very much, Mr. Hammerschmidt.

The gentlewoman from Missouri, vice chair of the subcommittee.

Ms. HORN. Thank you, Mr. Chairman, and thank you for your continuing interest as I understand this is continuation from the last Congress. Of course, the attendance of so many witnesses also stresses the very vital interest in these issues as others have commented in this very rapidly changing world of aviation and world markets and the effects it is having on our airlines here in the United States.

Being from the Second District in Missouri, where the airport, Lambert Field, the hub of TWA, and TWA has been a very vital concern to me since even before election day. The competitiveness and viability of the airline industry in the United States cannot be stressed too much. I think that was a very interesting part in some recent decisions by the Department of Transportation on the route sales before route sales had been approved for Pan Am and TWA.

In this last package as it affected TWA, some route sales were approved and some were not. I would very much be interested in our discussions that apply to the fact of the routes are really concessions that are given to the airlines. Sometimes they are traded back and forth among the airlines. There does seem to be the ability on the part of the Department of Transportation to say, wait a minute, this is not in the interest of us all to have this transaction take place, so we will take this back and put it up for bid.

So I am very interested in all those issues as they apply to the airline industry in general and, of course, with particular interest on those things that affect my district.

Thank you, Mr. Chairman. I do appreciate this opportunity.

Mr. OBERSTAR. Thank you.

Gentleman from Missouri, Mr. Hancock.

Mr. HANCOCK. I would just like to—he left. I was going to compliment the Congressman from New Jersey on his statement having to do with the manufacturing capability in this country. After all, one of our jobs up here is to try to protect American jobs as much as possible. In fact, I think that may be even more important than protecting our own job in the United States Congress.

The competitive pressure that we are going to have as our airline fleet ages are immense and the foreign manufacturers are definitely zeroing in on that. In fact, several foreign governments are starting to address the issue. We have the situation in France. Also there is a possibility that Japan is going to start looking seriously at the manufacturing of airplanes. This is an area that I think is a key that we need to look at other than just the capital investment of foreign countries because even though we allow some foreign carriers to invest in America's airlines, if the foreign countries end up manufacturing the hardware, we have some serious problems.

Thank you.

Mr. OBERSTAR. I thank the gentleman for those thoughts, and I certainly share those concerns.

The gentlewoman from Michigan, Miss Collins.

Miss COLLINS. Thank you, Mr. Chairman. I would like to thank you for calling this hearing to review our Nation's international aviation policy and our bilateral agreements with other nations.

As the world evolves and our relationship with other nations change, so must our international aviation policy. Too many barriers exist which prevent U.S. air carriers from providing the most efficient service possible.

As a member of the subcommittee, I look forward to the opportunity to work with you and the entire subcommittee on an open discussion of these issues and to ultimately finding solutions to the various problems we face in the international aviation arena.

Again, Mr. Chairman, thank you for this opportunity.

Mr. OBERSTAR. Thank you.

The gentleman from North Carolina, Mr. Ballenger.

Mr. BALLENGER. Thank you, Mr. Chairman. I would like to say that our area of North Carolina is developed so industrially that international air connections have become very important and I think you know the difficulty we have had with bringing the German airline in and the discussions that we are having at the present time. But I think in the long run we do need some connections along those lines, and I hope that the Department of Transportation is still working on the possibility there and look forward to the discussion that comes up in the meeting.

Mr. OBERSTAR. Thank you.

The gentleman from Tennessee.

Mr. CLEMENT. To move the hearing on expeditiously, I would just ask that the opening statement be incorporated into the record as if read.

Mr. OBERSTAR. Without objection, so ordered.

[Mr. Clement's prepared statement follows:]

BOB CLEMENT
6TH DISTRICT, TENNESSEE

COMMITTEE ON
PUBLIC WORKS AND TRANSPORTATION

COMMITTEE ON
MERCHANT MARINE AND FISHERIES

CONGRESSIONAL TRAVEL AND
TOURISM CAUCUS
STEERING COMMITTEE



Congress of the United States
House of Representatives
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THE HONORABLE BOB CLEMENT
STATEMENT BEFORE THE
SUBCOMMITTEE ON AVIATION HEARING
ON REVIEW OF U.S. INTERNATIONAL
AVIATION POLICY AND BILATERAL AGREEMENTS
MARCH 19, 1991

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I WOULD LIKE TO THANK YOU MR. CHAIRMAN FOR SCHEDULING THESE HEARINGS ON THE STATUS OF OUR INTERNATIONAL AVIATION POLICY AND BILATERAL NEGOTIATIONS. I ALSO WANT TO COMMEND SECRETARY SKINNER FOR TAKING ON THE EXTREMELY TOUGH TASK OF ATTEMPTING TO CHANGE THE ELABORATE SYSTEM THAT RESTRICTS ACCESS AND REGULATES FARES IN INTERNATIONAL AVIATION. ALL THIS COMES AT A TIME WHEN THE DOMESTIC AIRLINE INDUSTRY IS REELING FROM HIGH DEBT AND HIGHER COSTS WHICH HAVE RESULTED IN REDUCED COMPETITION AMONG THE AIRLINES.

I WOULD LIKE TO SEE INCREASED INTERNATIONAL AVIATION ACTIVITY, ESPECIALLY TO NASHVILLE, TENNESSEE. OUR AIRPORT IN NASHVILLE WAS DUBBED INTERNATIONAL IN 1988, BUT THE ONLY FLIGHTS OUTSIDE THE UNITED STATES OUR FROM TORONTO, CANADA. THE CURRENT SYSTEM OF BILATERAL AGREEMENTS BETWEEN COUNTRIES HAS WORKED WELL IN THE PAST BUT IT REALLY MAKES IT HARD ON CITIES LIKE TO NASHVILLE TO COMPETE EFFECTIVELY FOR EXPANDED INTERNATIONAL AVIATION SERVICE.

LAST DECEMBER, I WAS PART OF THE AVIATION SUBCOMMITTEE DELEGATION THAT WENT TO OTTAWA, CANADA. WE MET WITH MEMBERS OF THE CANADIAN

PARLIAMENT, TRANSPORT MINISTER LEWIS, AND OTHER GOVERNMENT OFFICIALS AND REPRESENTATIVES OF THE CANADIAN AVIATION INDUSTRY. OUR TRIP CAME ON THE HEELS OF ANNOUNCEMENT LAST FALL IN WHICH THE UNITED STATES AND CANADA WILL AGREED TO BEGIN DISCUSSIONS ON A NEW "OPEN SKIES" AGREEMENT. CLEARLY, IT WILL NOT BE EASY. THERE ARE STRONG ADVOCATES IN SUPPORT OF, AND AGAINST, AN OPEN SKIES AGREEMENT. IN ADDITION, THE NEGOTIATORS WILL HAVE TO DEAL WITH LOGISTICAL PROBLEMS.

WHEN THESE DISCUSSIONS BEGIN, THE INDIVIDUALS INVOLVED IN THE NEGOTIATIONS WILL NOT BE ABLE TO FLY DIRECTLY BETWEEN WASHINGTON AND OTTAWA. WHEN THEY FLY THEY WILL HAVE A SCHEDULED STOP OVER IN SYRACUSE, NEW YORK SINCE THERE IS NO DIRECT SERVICE BETWEEN THE TWO CAPITOLS. I SUGGEST THAT THE OPEN SKIES NEGOTIATIONS SHOULD TAKE PLACE IN SYRACUSE. THAT WAY EVERYBODY COULD GET THERE ON A DIRECT FLIGHT!

MR. CHAIRMAN, WE'VE SEEN THE WALL DIVIDING WESTERN AND EASTERN EUROPE COME DOWN. NOW ITS TIME TO BEGIN TEARING DOWN THE WALLS THAT WERE ERECTED TO PREVENT OPEN SKIES AROUND THE WORLD.

THANK YOU MR. CHAIRMAN.

Mr. OBERSTAR. The other gentleman from Tennessee.

Mr. DUNCAN. Thank you, Mr. Chairman, but I have nothing.

Mr. OBERSTAR. Thank you. Before we proceed, I will place in the record, at this point, a statement from our colleagues from Illinois, Jerry Costello and Glenn Poshard.

[Mr. Costello's and Mr. Poshard's prepared statements follow:]

STATEMENT BY U.S. REPRESENTATIVE JERRY COSTELLO, ILLINOIS, SUBCOMMITTEE ON AVIATION, REVIEW OF U.S. INTERNATIONAL AVIATION POLICY AND BILATERAL AGREEMENTS—MARCH 19, 1991

Mr. Chairman, today we will continue our inquiry into U.S. international aviation policy, an area in which new developments seem to occur each week. Just last week, we learned that the Department of Transportation had decided to approve the sale of some, but not all, of TWA's London routes to American Airlines. I am interested to hear Mr. Shane's testimony as to the rationale behind this decision and the plans for allocating the remaining three routes. What does DOT expect the effects of this transaction to be on the economic viability of TWA and on overall competition in the airline industry?

I am also interested in further exploration of the issue of foreign investment in U.S. air carriers. While this Committee has touched on the subject with Secretary Skinner recently, I feel that this discussion must continue.

I would like to welcome our witnesses today, and I thank you, Mr. Chairman, for convening this hearing.

STATEMENT OF HON. GLENN POSHARD

Mr. Chairman, I am pleased to submit this statement for the record for today's hearing reviewing International Aviation Policy and Bilateral Agreements.

With the fierce competition deregulation has brought about, it is going to become increasingly important for us to carefully examine how the purchase and sale of international flights can affect an airline's profitability. We also need to examine whether the sales of international routes are in any way circumventing the carefully constructed system for awarding international routes to American carriers.

Along with most of my colleagues, I am also concerned with America's trade imbalance and I am interested in looking at how we might open more foreign markets to service by American airlines.

I hope today's witnesses will give us some insight into these and other issues, and I look forward to hearing their testimony.

Mr. OBERSTAR. We will proceed as we do in all these matters in international aviation trade with our principal, foremost negotiator and expert of long standing in the field, Mr. Jeffrey N. Shane, Assistant Secretary for Policy and International Affairs, who has worn the State Department's hat, the Department of Transportation's hat at various times in these negotiations, and also has a long and distinguished career of public service in the field of aviation trade.

Welcome to our hearing, Mr. Shane.

TESTIMONY OF JEFFREY N. SHANE, ASSISTANT SECRETARY FOR POLICY AND INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF TRANSPORTATION

Mr. SHANE. Good morning, Mr. Chairman, and good morning to the other members of the other subcommittee. Your opening statement and the other opening statements make clear, Mr. Chairman, that we are in a time of enormous challenge and also enormous opportunity. On behalf of Secretary Skinner, I just wanted to express our great appreciation to you for holding this hearing.

As we move into this time of challenge and opportunity it is essential that the Executive Branch stay very closely in touch with the Congress. We are charting some new waters, and it is important that we all know where we stand and why we are doing what we are doing.

Mr. Chairman, I have a prepared statement and I would ask permission that it be introduced into the record as presented, although I would like to summarize it.

Mr. OBERSTAR. Without objection, the entire statement will be included in the record. It is a very complete presentation and will be very helpful for future purposes.

Mr. SHANE. Thank you, sir. Since I last appeared before this subcommittee in October to testify on U.S. international aviation policy, the operating environment for international aviation has been extraordinarily difficult. Although fuel costs have declined markedly to levels approximating levels that existed prior to Iraq's invasion of Kuwait, the war has had a significant negative impact on the level of U.S. carrier transatlantic traffic. In addition, a soft U.S. domestic economy contributed to an already difficult operating environment.

With the success of our Armed Forces in the Gulf and the end of hostilities, it now appears that the fear of terrorism is abating. The media are reporting increased interest on the part of travelers in flying again which should mean near-term improvements in air traffic.

Although the latter part of 1990 was a difficult time for the U.S. international aviation industry, results for the full year showed good traffic gains in most areas. According to DOT data, on a revenue-passenger-mile-basis, in 1990 U.S. carriers' international passenger traffic increased almost 15 percent over 1989. This increase was distributed very unevenly throughout the world. Transatlantic traffic rose 8 percent, transpacific traffic surged 24 percent, and Latin American traffic increased a strong 14 percent.

The strong 1990 passenger traffic increases were achieved despite the fact that the transatlantic market sustained declines of 5 percent for both November and December. The really severe downturn in international traffic for U.S. carriers occurred in February when, according to data provided to us by the Air Transport Association, passenger traffic plummeted about 27 percent. Fortunately, as you know, the geopolitical situation has improved dramatically, and we believe U.S. carriers can look forward to more normal traffic levels now.

The international air cargo market for U.S. carriers in 1990 was nearly flat, with scheduled freight-ton-miles increasing overall by just 3 percent. The transatlantic market for the year was down about 4 percent while transpacific cargo rose 8 percent, and the Latin American cargo market grew over 7 percent. In January overall international freight dropped almost 8 percent from year earlier levels.

Although international traffic was up for the U.S. airline industry overall in 1990, it is estimated that for both international and domestic operations, the industry lost \$2 billion for this period, making it by far the worst year ever for this industry.

How could that have occurred considering that its international traffic was up? A big part of the explanation is that international passenger traffic accounts for only about one-quarter of the industry's business, and the U.S. domestic market in 1990 was not as strong as the international market.

Also, industry costs soared when fuel costs escalated. I would add that high operating costs, especially debt service and labor costs, no doubt contributed to the losses experienced by some carriers.

Now, Mr. Chairman, with your permission, what I would like to do is summarize the broad categories that are spelled out in my prepared statement because I know that the subcommittee will want to get into questions and answers, and so do I.

You have already discussed the question of foreign investment, as has Congressman Clinger. As you are aware, Secretary Skinner, in addressing this subject several weeks ago, announced that while he was not proposing at that time that any change be made in our statutory limitations on foreign investment in U.S. airlines, as an administrative matter, as a matter of Department of Transportation policy, we would not consider investments up to 49 percent of the equity of a U.S. airline to represent, without a further investigation, the impermissible level of control specified in our statutes.

Moreover, we would not see debt from foreign lenders, borrowings from foreign lenders as indicia of control. That is not to say that we are relaxing our vigilance about foreign control. The law still requires that U.S. citizens control U.S. carriers. A carrier cannot be a U.S. citizen corporation unless it is controlled by U.S. nationals. It was Secretary Skinner's view, and this is what he said in outlining what the policy of the Department will be, that there was room for relaxation of our administrative interpretation of the statute, and the adjustments that I have just described are now a part of Department of Transportation policy.

We are aware, of course, of the bill introduced by Congressman Clinger a few weeks ago. We are studying that closely. We are supportive of the notions there. We believe it will require some further scrutiny and discussion. The administration has not declared a position, and I do not bring an administration position on the bill to you this morning, other than to say we are certainly supportive of the initiative represented in that legislation. I would be happy, of course, to engage in a discussion of it if the subcommittee wishes.

You are familiar, Mr. Chairman, with our Underserved Cities Program. That is a program whereby under certain circumstances—namely, we have a liberal agreement with a foreign partner, we have a city in the United States that is not served to that foreign partner, and we have a foreign carrier seeking to provide such service—now the Department of Transportation under those circumstances will in most cases say yes to the application by the foreign carrier for service.

The most recent addition to the number of routes added to U.S. communities through the Underserved Cities Program is KLM's new service to Minneapolis-St. Paul. As you know, that brought the total of such services to five. Minneapolis-St. Paul for KLM is the most recent. KLM is also serving BWI under the program. Swissair is serving Philadelphia. Lufthansa is serving Charlotte. LADECO, a Chilean carrier, is serving Washington, DC.

I know we are going to spend a good portion of our time this morning discussing the bilateral agreements that we have struck recently, particularly with the United Kingdom, so I will not say very much about that in my opening statement. I am sure we will get into enormous detail about that as time goes on. I do just want to register that we have concluded those negotiations and concluded them much to our satisfaction.

As you said, Mr. Chairman, we will begin shortly to negotiate with Canada. The first round of those negotiations is scheduled to take place in Ottawa in April. On February 12 Secretary Skinner and his Canadian counterpart, Transport Minister Doug Lewis, met here in Washington and simply underscored their determination to move those negotiations to a fruitful conclusion in pursuance of the initiative which they jointly announced on October the 3rd.

I believe the subcommittee is aware of the fact that we ran into some obstacles in implementing our 1989 bilateral aviation agreement with Japan. Those obstacles were principally in the area of landing and take-off slots at Narita Airport.

I am pleased to report that after informal discussions between the United States government and the government of Japan, discussions which ultimately included all of the carriers who were affected by those impediments, we have now reached a solution that we regard as satisfactory, and we anticipate the full and normal implementation of that very important bilateral agreement with Japan on aviation.

Since October, Mr. Chairman, we have conducted bilateral negotiations with Nicaragua, Guatemala, Yugoslavia, Spain, Czechoslovakia, the Federal Republic of Germany, and the People's Republic of China. We have also met with a number of Central American transport ministers to discuss the importance of more liberal arrangements within Central America for aviation. Out of those negotiations came three agreements: with Yugoslavia, Czechoslovakia, and China.

We have negotiations going on this week both with Greece and with Thailand. We are planning in the upcoming weeks to have talks with Barbados, the Dominican Republic, Jamaica, Spain, Belgium, Switzerland, Germany, and Italy.

That just gives you, Mr. Chairman, a flavor of the busyness of this bilateral negotiating activity that has been so enormously challenging. It is now gratifyingly the subject of increasing attention both here in Congress and throughout the country, understanding the enormous benefits which flow to the U.S. economy from the bilateral agreements that we try to shape through those negotiations.

We continue our informal discussions with the European Community and particularly the European Commission in Brussels. There are no prospects at this point for any broad or multilateral negotiations with the European community on aviation. Our efforts are primarily for the purpose of ensuring that the European Commission, in its issuance of regulations moving into the single European market, does so in ways that do not adversely affect the prospects for U.S. carrier services to Europe. We are vigilant on that front.

There seems to be now a prospect that we will renew our discussions in the GATT toward a completion of the Uruguay Round. As you know, I am particularly concerned about the impact of a GATT agreement on aviation. My concern is that, as I look at the framework for services and try to game out how that framework might be applied to aviation services in particular, it is not at all clear to me and I believe it is not at all clear to this administration that a framework of that kind would, in fact, be a liberalizing agreement for the purpose of aviation. For that reason we are in very close touch with our friends at USTR and having important discussions there about how to carry these negotiations forward.

A free-trade agreement is of enormous importance to the United States, and we are not trying to get in the way of that; but we do have reservations about the way in which the services framework agreement that we saw leading up to the ministerial in Brussels last year would have affected aviation.

I would also refer to the Montreal Protocols as another important initiative—recognizing, of course, that the action for purposes of ratification of those important treaties rests with the Senate. We have an absolutely antiquated regime right now for the liability, the obligations that airlines have to their passengers after an accident that takes place in international aviation.

The Montreal Protocols and a supplemental compensation plan which has been put together represent the solution to a long festering problem. At a time when more and more Americans are flying abroad and particularly buying tickets in foreign countries for travel to other foreign countries, this country cannot wait any longer for an updated and much fairer regime for the handling of mishaps of that kind.

In closing my prepared statement, Mr. Chairman, I would like to return to the circumstances created by the war in the Gulf and report on the role of the CRAF Program and the military effort. In support of Desert Shield/Desert Storm, the CRAF airlift has, as of March the 4th, involved 25 airlines and over 3,200 flights transporting over 300,000 people and 140,000 tons of cargo.

About 63 percent of Desert Shield/Desert Storm personnel were moved on commercial aircraft and 27 percent of the cargo.

Clearly, the CRAF program proved to be a vital element of the war effort. The strength of the CRAF program is, of course, dependent upon the health and capabilities of the U.S. commercial airline fleet. Without a thriving international airline sector, we cannot maintain a strong CRAF program. This is one reason why it is critical that our international transportation policies serve to foster the economic health of this critical industry.

I can assure you that Secretary Skinner and all of us involved in this area at the Department of Transportation are committed to that objective.

Mr. Chairman, that concludes my prepared statement. Now, of course, I would be pleased to answer any questions you or the other members may have.

Mr. OBERSTAR. Thank you very much, Mr. Shane, for both your delivered and prepared remarks and your observations about the Montreal Protocol. Before I get into other points, I can certainly say for Mr. Hammerschmidt and myself, both of us served on the

President's Commission on Aviation Security and Terrorism, the so-called Pan Am 103 Commission. One of the significant, and there were many of them, recommendations in the Commission's report was to ratify the Montreal Protocol.

We have strongly urged the Senate to ratify the agreement. Both Mr. Hammerschmidt and I have been active with our colleagues in the Senate to encourage ratification. I think it is vitally important to update all of the various elements which we need not go into here, but I think it is important to the work of that commission and justice to be done for the families of Pan Am 103, and God forbid any future victims of aviation terrorism.

We are very concerned about GATT and aviation. Last year a very significant number of members of Congress joined me and Mr. Clinger in urging that aviation not be included in the GATT services program. You get close to 200 members of the House expressing a viewpoint on that subject without hardly lifting a finger. I mean, we just circulated a letter, and we had signatories on that matter. It gives you an idea of how strong the concern is in the Congress that aviation continue to be negotiated as it has in the past so successfully under the civil aviation bilateral agreements, that aviation not be considered a service item under GATT, and that aviation rights and values not be traded off for rights and values in some other trading sector.

It is good to see the Department shares that view, at least to some extent. I do not know to what extent the OMB is allowing you folks to do what you know in your heart to be right. I think you understand very well because you have so vigorously participated for much of your public career in the negotiation of bilaterals. You know how important they have been to maintaining a level playing field and an opportunity for U.S. carriers to compete effectively and to return to the U.S. the benefits of a fair trading regime. So I encourage you to pursue them.

I would like to come back later on another round of questioning to the U.S.-U.K. agreement on Heathrow, and to a number of matters there that trouble me. I wanted for a moment to explore with you the broader picture.

Overall, as I think you have discerned from our hearings over a period of years, I feel very confident and impressed with the quality of our aviation negotiators. There was a time when we had so much turnover in the negotiating field that we were at a great disadvantage, particularly with the Japanese. If my memory serves, the same chief negotiator for Japan who negotiated the 1952 agreement continued to negotiate well into the eighties. There was kind of an institutional memory that is so valuable in those settings that just cannot be overstated or underestimated.

Meanwhile, while we have had very good people and they are quick studies, it takes time to get up to speed; it takes time to understand the nuances of an ongoing negotiation.

You have now been in place, the Department of Transportation, Department of State, and back to DOT so that I have great confidence in your recall of issues, understanding of past negotiations, and their implications for the future.

That puts you in a very unique position to look to the long term. Perhaps difficult to do when you are engaged as you have just described for us in a rapid fire set of negotiations, one after the other.

A couple of years ago we engaged in an exercise to look at a broad regime for cargo policy, to separate cargo negotiations from passenger negotiations so cargo rights would not be traded off for passenger rights.

What is the five to ten-year outlook? What is the department's view for the balance of this decade? What are your broad policy objectives for international aviation? How do you view the scene in international aviation trade; first Europe, then the Pacific Rim? Has the department undertaken a sort of white paper, that is, a "deep think" approach to this subject matter; or is the department content to move ahead ad hoc lurching from agreement to agreement?

Mr. SHANE. There is not a white paper, but I would strongly disagree that we are moving ad hoc from agreement to agreement. I think it is important to recognize first that what we learned about our domestic transportation system in the context of the National Transportation Policy which Secretary Skinner and the President issued a little over a year ago is true of international transportation. That is, it is a service. Its purpose is to facilitate trade and business and, of course, tourism and recreational travel as well.

It is critical to the growth of our national economy that we have the most efficient transportation services flowing to and from our country that we can. Thus, it is terribly important as we move into any kind of tactical decision-making process about the negotiating process or international aviation policy, that we not lose track of that essential purpose of the exercise. It is fair to say that we must have a strong national transportation industry, and it must include a strong airline industry. Everything we do in our negotiations is designed to ensure that we come out at the end of the process with a strong national transportation industry and a strong airline industry. What just happened in the Gulf underscores the reason why we can never allow any of those concerns to be eroded one iota.

At the same time we must recognize that it is the expansion of transportation overall that has to be the ultimate objective. That is what flows benefits to our communities, to our local and state economies, and ultimately what flows benefits to the national economy. We do not have the luxury of getting into very mercantilistic exchanges with mercantilistic-minded countries about who wins and who loses one flight or another flight in a bilateral negotiation that simply does not live up to the needs that today's economy presents us with.

We are certainly aware that as business globalizes generally, the airline business is globalizing. One must pay attention to the tendency within the industry to seek joint ventures, marketing partnerships, and linkages of all kinds that now bridge national boundaries in ways that would have been unthinkable just a few years ago, and to ensure that our policies facilitate those kinds of arrangements for the benefit of U.S. carriers.

We feel confident that we have been flexible in that regard, that we have been able to show that flexibility without taking steps det-

rimental to U.S. carrier prospects in the international marketplace. In fact, we think we have enhanced U.S. carrier prospects in the international marketplace.

Mr. Chairman, you have talked about the linkage between cargo and combination services. I would hope that cargo would be the crucible in which we test some genuinely liberalizing ideas for aviation. The players in our all-cargo market are very interested in seeing if we cannot break down some of the traditional rules that simply get in the way of their doing the kind of business they want to do. If we can find some like-minded partners out there, it will be a very exciting thing to try and, indeed, it might very well prove to be a model upon which we can base future efforts on the passenger side.

Turning to the passenger side, I would have to say that in Europe it is our expectation that there will ultimately—nobody can predict how quickly—but there will ultimately be a negotiation between the United States, or perhaps a North American integrated market if our negotiations with Canada prove to be successful, and on the other side, the European community. I think that once there is a genuine liberalized aviation market within Europe, we will be talking to a market on the other side of the negotiating table comparable to our own in size and in vitality and economic productivity.

That, Mr. Chairman, should make for a very interesting negotiation about the transatlantic market. It seems to me that if we have our heads screwed on right, we ought to be able to translate that negotiation into an agreement and into ultimately a market that is tremendously beneficial to the U.S. players in that market that provides much greater opportunities to those airlines than they have at the present time. That would be our expectation.

On the Pacific side, I see more prospects for markets on the Asian side even though it will be a long time in coming. On the other hand, our relationships with many Asian countries are quite liberal. Traffic and trade across the Pacific continues to grow by leaps and bounds, of course, even with the slowdown that we've just experienced through the Gulf. And I would anticipate that we would anticipate greater and greater success as time moves on across the Pacific.

Mr. OBERSTAR. With regard to Europe, is it the department's policy to continue to negotiate and update the bilaterals while awaiting Europe's own decision about its internal market in the 1992 and beyond Europe; or is the department more or less marking time, watching developments, awaiting Europe's own internal decisions? Major policy questions such as cabotage within Europe have not yet been resolved within the European Commission framework and until we understand how Europe is going to conduct its own internal affairs among its member countries, we cannot fully benefit from those developments or we may find ourselves at a disadvantage. What is your thinking about that subject?

Mr. SHANE. Mr. Chairman, we have an absolute obligation to both our carriers and our communities to continue to try to extract as many new opportunities out of the present Europe that we can. So our determination is to continue to work with our bilateral partners in every way that we can to ensure that we're maximizing the

number of those opportunities that are available. They are terribly important to our country and I don't think it would make any sense at all to simply wait for some brave new world of liberalized European aviation before we start making more progress.

The fact is we cannot know how long it will be before we will be able to make progress on that more liberal——

Mr. OBERSTAR. Your policy will be to continue the bilateral regime until such time as Europe has its own, as we say, act together?

Mr. SHANE. Absolutely. I must say, though, at the same time that, not through any fault of our own, I have seen a steady diminution in the kinds of returns we are getting out of the bilateral process in Europe, partly because I think our European partners are themselves marking time. They are reluctant to enter into interesting new trades with us that might involve some new Fifth Freedom Rights within Europe for U.S. carriers that might begin to compromise some of the things I suppose that the European Community is hoping to do together, perhaps together in negotiations with the United States.

It is hard to psychoanalyze our partners and to understand exactly why the negotiations are moving in that direction. But I have found that the kinds of dramatic leaps forward that we were accustomed to seeing in the late 1970s and early 1980s, even into the mid-1980s, are fewer and farther between at this point in time and I think that is because our European trading partners are more focused on what is going on within Europe, the enormous challenge they face in trying to forge a single policy out of 12 national policies right now, and I think we can all understand why that may be the case.

That's partly why the Secretary felt it might be useful to explore whether or not there might be opportunities for increasing the flow of services to the United States from foreign carriers, even without the negotiating process being a necessary part of the equation—where, in fact, we have everything out of a particular bilateral relationship that we could possibly ask for. There's nothing more in a bilateral context that you can negotiate for with particular partners in Europe, so we shouldn't hold up an expansion of those services because we don't have a negotiation going on.

Mr. OBERSTAR. I will have some further questions, but I don't want to pursue that, while this is a very important matter, I want other members to act on their agenda.

The Chair recognizes the gentleman from Pennsylvania, Mr. Clinger.

Mr. CLINGER. Thank you, Mr. Chairman.

Mr. Shane, thank you for your always helpful testimony. Just following up on one of the Chairman's line of questions in regard to the prospects for more liberalized European Community. I guess the concern I would have is, yes, the possibility of potential exists there, but if, for example, the European Community ends up by weaving existing U.S. carrier rights in Europe as cabotage and, therefore, would be insisting on a similar arrangement in the United States, I think we end up the loser in that kind of a climate. Would you agree with that?

Mr. SHANE. Well, I am not sure whether I would agree. I think that the fear that the Europeans are going to start taking away our Fifth Freedom Rights or begin to bargain for cabotage rights is probably more speculative than real at this point.

Our Fifth Freedom Rights are rather more scarce than our European friends would give us credit for. I don't think they really count very much in terms of competition within Europe. I don't believe our Fifth Freedom Rights are a competitive threat to the European carriers that are serving those same internal European routes. And I also don't think that cabotage opportunities in the United States are the be all and end all for foreign carriers either. I believe, in short, that the cabotage question, while it is not an insignificant question and it certainly has to be part of any negotiation, ultimately, that we have with the European Community, is probably a smaller economic question than a lot of us would be led to believe by some of the rhetoric that we hear.

Mr. CLINGER. Do you know what the status of their directive that they have been working on now for some months, indeed years, is? Are they getting closer to something that the Commission has agreed to?

Mr. SHANE. I believe so, and I think they still anticipate making their end of 1992 deadline for unifying the market. There has been a pause, if you will, in the liberalization of the European market as a result of events in the Gulf. There were directives that came out that essentially authorized the suspension of the normal competitive rules to enable the carriers to get over the kind of economic hump that our carriers have been suffering from in this market for so long. But I would expect that they would get back on track very quickly in the spring.

Mr. CLINGER. As I said in my opening statement, I believe that the globalization of the aviation industry is on-going and I think you would concur that globalization is going on in the entire world economy. But what are the implications if we allow the normal free market processes to work and then find ourselves dealing in a competitive forum with foreign carriers that are heavily subsidized by their national governments? Doesn't that put the U.S. at a rather significant disadvantage when we do not subsidize our airlines? If we allow the barriers to break down that presently would inhibit globalization, what kind of implications does that have for the survival of our domestic carriers and their ability to compete in a world market?

Mr. SHANE. That's right, I think we would be making a very serious mistake if we didn't pay attention to the very different corporate organization of carriers in a number of other countries. Happily, we are seeing a movement toward the privatization of heretofore government-owned airlines, and with that privatization you can expect—because nobody's economy is particularly flush at the moment—that governments are going to find ways of getting out of the business of funneling money into the airline business. They have no business doing that, there isn't any reason to do it, and the airlines ought to be able to stand on their own.

I believe as you see a more liberal European market that the concept of flag may eventually diminish in importance to our European friends. They may end up with the kinds of consolidation

taking place within Europe that we have seen after deregulation in our country such that you will have, in effect, multilateral carriers providing the internal European services that national carriers have provided, very often in a very inefficient way, in Europe up to now. And once that happens, it seems to me that particular governments have less of a stake in trying to subsidize a particular national carrier. I think that's a long-term trend that will benefit U.S. carriers.

We have seen even where carriers are government-owned that the U.S. carriers continue, in spite of some very high costs that they have to suffer from themselves, continue to have by and large lower operating costs than their European competitors. Even the subsidization doesn't skew the market very much. They still do very well in competition with their European friends. I would expect that would continue to be the case. Our carriers, after all, come out of this deregulated jungle of a market that we've created and they know how to compete. European carriers are going to have to catch up, there's no question about that.

Mr. CLINGER. On another subject, you indicated that the Department had taken no position on my bill with regard to foreign investment. I wonder if you could tell us, is it because you view the approach as too restrictive, not restrictive enough, or what concerns might you have with it?

Mr. SHANE. No, I would not characterize our position as being concerned at this point one way or the other. In fact, Secretary Skinner instructed me to let you know that he was intrigued with the ideas in the bill. I think I would characterize, if we have any concerns, our concern as being almost at the technical level. For example, I am not sure, I would have to go back and look at the language, but it seems to me there might be an insufficient distinction between a government-owned carrier and a privately-owned carrier in that bill such that we—you know, getting back to your earlier question—might very well want to offer some suggestions about how to make clear that we are interested in having private carriers operating in the U.S. markets through the investment vehicle and not government-owned entities, because that would skew the market quite considerably.

Mr. CLINGER. Well, I think I would be very supportive of that kind of improvement. I think our objective was to make it clear that we recognize that globalization is going to go on and the need for capital for our own carriers, there has to be some sort of restrictions, conditions to make sure that we are not put at a disadvantage by having the foreign capital investments here.

I believe my time has expired, Mr. Chairman. Thank you, Mr. Shane.

Mr. CLEMENT [assuming Chair]. Secretary Shane, when the Department of Transportation considers new routes, let's say an American city to London, to what degree does the Department use gateway interest in selecting the new routes as opposed to carrier interests?

Mr. SHANE. It is a combination of considerations. We have, usually, several different candidates competing for these opportunities and the time-honored way, if you will, of making these difficult and, frankly, awkward selections is to just try to determine on as

quantitative a way as we can which carrier services to which community are going to flow the greatest economic benefits to the United States. That is to say, who will carry the most traffic, who will provide new service to the greatest number of Americans, possibly even the greatest number of communities, who is going to provide really the most efficient exploitation of that scarce resource that we've obtained in a bilateral agreement?

Mr. CLEMENT. Should gateway interest be given more weight than it currently receives today in determining new international routes?

Mr. SHANE. Gateway interests have always been paramount in the determination of who gets a route. Usually a carrier and a community bring a proposal to the Department of Transportation jointly. They have to demonstrate that the combination of that carrier and that community will end up bringing enormous benefits to the American economy by virtue of its location, the population, the role that it plays in the aviation system between the United States and the foreign country involved such that the gateway is a critical part of the equation.

Mr. CLEMENT. Well, what about TWA recently wanting to sell their route authority to London, for example. TWA simply is implying that we can't afford to do this. This is going to be very expensive, and knowing full well they probably are not going to give the type service, quality service, continued service, and yet American Airlines is prepared to provide that service. And yet they have got to Show Cause Order now where they are barred from being able to offer that service.

Mr. SHANE. We have a Show Cause Order.

Mr. CLEMENT. Yes. DOT issued the Show Cause Order.

Mr. SHANE. Congressman, I know this is going to sound like a cop-out, but because I signed the Show Cause Order and because we are waiting for public comment on it, I don't want to get into the details of that Show Cause Order.

I would like to take the question, if I may, in a more general way. The prospect of one airline selling an international route to another is contemplated in the Federal Aviation Act in section 401(h). It says there that those sales shall be permitted if in the public interest, as determined by the Secretary of Transportation. When the Secretary makes a determination as to whether or not a particular sale is in the public interest, he has to consider the quality of the service that will be provided by the purchasing carrier. He also has to consider the competitive structure of the U.S. market, and particularly the U.S. international market.

And so when he issues an Order to Show Cause through his designee, which happens to be myself, when he issues an Order to Show Cause specifying how he would propose to treat the transaction—and you saw an example of it in the case of TWA and American—he is offering a view as to how best to maximize the economic benefits of these international routes that we have to a particular foreign country. It clearly would be his view where routes are proposed to be spun off that leaving all of those routes in the hands of a single player would not be entirely consistent with maximizing the competitiveness of the U.S. airline industry.

Mr. CLEMENT. But are we talking about—this FAA Act says transfer not sale.

Mr. SHANE. Yes. Well, a transfer without money involved would be permissible under the Act but we haven't seen too many routes transferred for no money.

Mr. CLEMENT. And also when you refer to a Show Cause Order, is this temporary? Could it be more temporary than a permanent decision on your part?

Mr. SHANE. Well, no, sir. The decision would be permanent. It is part of the Administrative Procedure Act process. We issue an Order to Show Cause why we should not make a particular decision, get comments, then decide whether to make the decision as we have laid it out in the Order to Show Cause or whether we should modify it on the basis of comments that have been received.

Mr. CLEMENT. But this Show Cause Order still could be set aside after the public comment?

Mr. SHANE. Absolutely. The Secretary has full discretion to modify the proposed disposition of the transaction as it was laid out in the Order to Show Cause.

Mr. CLEMENT. Well, I used to be on the Public Service Commission and just because I had a hearing examiner issue a Show Cause Order, that didn't necessarily mean that's the way it ended up finally.

Mr. SHANE. That's right. That is the process. And if I start commenting on what the reasons were for that particular Show Cause Order here, I am totally compromising that process. We want to take it seriously.

Mr. CLEMENT. Last January the Department announced a new program to expand international air service opportunities to more U.S. cities. Specifically, the program establishes a framework for granting eligible foreign air carriers extra bilateral authority to provide service at communities in the United States. What's the status of this program?

Mr. SHANE. We have five new routes now to the United States. They are outlined in my prepared statement: KLM is serving two—Minneapolis/St. Paul and BWI; we have a Chilean carrier coming to Washington, that's Ladeco; we have service to Philadelphia by Swissair; and Lufthansa is now serving Charlotte.

No negotiations preceded any of those routes. We are delighted with the services that our communities are getting. The communities are thrilled. They are bringing enormous economic benefits in. In fact, Secretary Skinner tapped what turns out to be a mother lode of enthusiasm within communities all over the country for having services of this kind. The tough call for us, of course, is that if we're not getting a fair deal from a particular foreign government in terms of the U.S. carrier services provided to its territory, then, of course, we are not in a position to give away things free of charge.

The services that have been authorized under the program are all consistent with our need to maintain a strong negotiating position, and I am confident that they all have done that.

Mr. CLEMENT. What exactly is the relationship between the Department of State and the Department of Transportation when bi-

lateral aviation agreements are worked out, and which department takes the lead?

Mr. SHANE. The Department of State provides the chairman for every delegation that we send abroad. The two agencies each have international aviation staffs that, I must tell you, practically look like one staff for purposes of conducting these negotiations. In the present environment, by virtue of the fact that my last job was Deputy Assistant Secretary of State for Transportation Affairs, meaning chief aviation negotiator, and the fact that the chief negotiator now, Chuck Angevine, was then my deputy, we have about as close a relationship as one could imagine between two executive branch agencies. We are, for all intents and purposes, one operation.

Mr. CLEMENT. All right. If you do have disagreements between the Department of State and the Department of Transportation, how do you resolve those differences?

Mr. SHANE. We just get together and we discuss them. They are healthy disagreements. We hope there will be disagreements from time to time because unless we have the sense that we're getting a variety of different views, we may not be looking at all of the options available.

Gene McAllister is my counterpart at the Department of State, the Assistant Secretary for Economic and Business Affairs. He and I talk frequently and I stay very closely in touch with his people and his people stay in close touch with me and my people. It is basically sorted out without any litigation of any kind.

Mr. CLEMENT. Thank you.

The Chair recognizes Mr. Laughlin, State of Texas.

Mr. LAUGHLIN. Hello, Mr. Shane.

Mr. SHANE. Congressman.

Mr. LAUGHLIN. Good seeing you. We participated in one of these international transportation conferences in Houston recently. We are on the same side of the table.

The first area of inquiry does not relate to the topic here, and you may not want to answer. Last fall Congress was involved in a great deal of negotiations along with a number of air carriers on noise problems, and an agreement was reached in which U.S. air carriers would have a schedule by which they would have Stage-3 aircraft and a timetable going out, as I recall, to 1990 when all would be Stage-3. Contrary to that agreement, which became law, someone in the bureaucracy of the Department of the Transportation wrote a rule that said that the air carriers would reduce Stage-2 by percentages each of these years.

To me, that is completely contrary to the agreement that was reached that places additional hardship on U.S. air carriers. And I would like the opportunity to be heard or visit with someone on that problem. Now, is that something that we can do? Are you familiar with the agreement?

Mr. SHANE. I am certainly familiar with it. It is a Proposed Rule that is out now and, indeed, many of the comments coming in I have a feeling will say very much what you have said. I know there is concern in the industry about that characterization.

Mr. LAUGHLIN. It is contrary to the agreement as all of us understood it that was involved. Although I didn't write it, I was there

when a lot of the discussion was taking place. We would just like an opportunity to be heard on that to see what the reason was to change the agreement.

Mr. SHANE. Yes. Well, this is, of course, the time when the Department is looking for communication of that kind. I will have to defer to our lawyers as to precisely what form that communication takes. Again, because it is a Notice of Proposed Rulemaking, we are supposed to guard against ex parte contacts, but Members of Congress may have access to the Department that take other forms. I just don't know exactly how they would propose to engage in that conversation, but I am sure the Secretary would want your views.

Mr. LAUGHLIN. Next, I want to turn to the topic you are here on and talk about Japan for a minute. It seems like every problem we've run into some way or another Japan is involved. Just this past weekend they kicked the rice people out of Japan. My understanding of the Japanese environment is they eat a lot of rice. Well, we grow a lot in my area and yet they won't let us sell any rice in the country.

If you go to Japan on a U.S. air carrier and, if you are extremely lucky, they get permission to dock at the terminal. If it is routine, you get to park out at the end of the runway at Narita and ride a bus in. None of the Japanese airlines do that at Narita. I only had one day of observation on that. They always get to dock at the terminal, whether it is in San Francisco, San Jose—which is not far away and I want to talk about that in a minute—and any other airport where you have the Japanese air carriers. And I just wonder why you all treat them fair and you don't treat them the way they treat our American companies? [Laughter.]

Mr. SHANE. Congressman Laughlin, I think we do treat them fair, and that means that if we are treated unfairly, we treat them unfairly. I am unfortunately a commuter to Tokyo from time to time and I can tell you I have boarded—I only fly U.S. carriers of course—because we have a Fly American Act and I have boarded lots of airplanes right at the terminal. We don't always get shoved off onto the tarmac.

Mr. LAUGHLIN. But when you are landing you get to get off out—

Mr. SHANE. I've done it both ways. And the fact is that U.S. carriers, although it may sound surprising, actually have more slots, more flights in and out of Narita in the aggregate than the Japanese carriers do at this point. So it is a very small airport, it is a one runway airport, and there are times when there simply are not gates that will accommodate the airplanes that come in and that happens with Japanese carriers as well as U.S. carriers.

We had a problem with landing slots as opposed to gates, which you may be aware of, and as a result of not having the landing slots and the take-off slots which U.S. carriers needed, Secretary Skinner simply held up the access which the Japanese carriers thought they were entitled to in the U.S. market; we just held it up. We held it up because we weren't satisfied that we could implement the agreement as we had understood we would be able to do. We have solved that problem through informal consultations, I think I referred to that in my opening statement, and the fact is

that we are implementing that agreement now and I anticipate that there will be no major problems in terms of the 1989 bilateral agreement that we struck with the Japanese.

Should there be problems of that kind, and I believe the subcommittee will be hearing from other witnesses about doing business issues, I can tell you—and I think our track record demonstrates—that we will take very seriously any obstacles to our enjoying the benefits of that market that we believe that we are entitled to that are necessary. Secretary Skinner feels very strongly about that.

Mr. LAUGHLIN. I realize you are not an administrative law judge or you are not the Secretary of Transportation, but I must take issue with any sense of a competitive selection of the air carrier service non-stop from the continental U.S. to Tokyo when the administrative law judge, backed up by the Secretary of Transportation, makes the decision that it is competitive to award San Jose, California, a non-stop flight—when it is somewhere between 18 and 25 miles from San Francisco; I am not quite sure of the mileage to Los Angeles—when at the same time the decision is made to deny the fourth largest city of the United States, that being Houston, a non-stop authority. I find no condition of fairness in that decision because the only non-stop from our State to Tokyo is Dallas/Fort Worth by a fine airline called American Airlines. But if you go to get off that, if you are in Houston, you have to get on an air carrier, fly to DFW, and if you don't make the reservation two or three weeks in advance you may get to wait three or four weeks before you can get on American Airlines flying non-stop to Tokyo.

So I have registered my complaint. I find offensive that any one in the Department of Transportation would come here and suggest that this had been a competitive hearing to award San Jose—I am not even sure where they rank in the size of cities—a gateway to Tokyo non-stop when it is closer to San Francisco airport than downtown Houston is to the international airport. While you probably were not in the chain of making that decision, I want to register my complaint.

Mr. SHANE. Thank you, Congressman. I am in the chain of the decision-making process. The Secretary of Transportation by and large is not. It is made by an administrative law judge as a recommended decision and then my deputy, Pat Murphy, is the final decision-maker. I have the authority to review and remand—or the Secretary could do the same thing if he chose to—but we can't substitute our judgment. The process is, in effect, a totally apolitical process. It was designed that way hopefully to avoid any taint of untoward political influence.

Your comments will certainly be noted. There was not very much that we could do, as you understand the process.

Mr. LAUGHLIN. Well, I fail to understand how it met the international competitiveness. You have a substantial Pacific Rim presence in the Gulf Coast of Texas and it is a hardship trying to get to Tokyo and beyond from that region of our State. It is some 180 miles to DFW. San Jose is closer to Los Angeles.

Mr. SHANE. My only comment is that I would hope the Congressman would understand where the real fault lies. The fault is in a process in which the United States Government has to make absolutely awkward decisions to sort out a finite number of routes to

the most important gateway in Asia. That's what is preposterous about the entire international aviation business, that we have bilateral agreements that don't allow us to simply open up the market to all carriers and all gateways that wish to be served or that wish to serve. It is the Japanese, I must tell you, that refuse to allow us to open up more gateways of the sort that you are looking for, that communities all around this country are looking for, that force us into this absolutely awkward and unhappy and completely unsatisfying process. There is always somebody disappointed by our trying to sort out who gets what route.

The Heathrow negotiation is another example of what I regard as hopelessly backward thinking on the part of our aviation partners. That's the big problem. We can't solve that problem overnight. It has to be done together with other sovereign governments. There is nothing we can do about that until the system changes. But I would hope you would understand that it is the insistence of our trading partners on treating these routes as a scarce resource rather than as opportunities that ought to be there for everybody that puts us into this box.

Mr. LAUGHLIN. Thank you.

Mr. OBERSTAR. The perennial problem of negotiations with Japan and their unwillingness to allow the United States to exercise the rights which we have negotiated, for which we have paid, and which we feel are our right to exercise, has to be a matter of longer-range concern for the Department, and one of those matters where I was hoping you would be thinking five or more years longer. We have run into this again and again with "doing business" issues.

You talked a moment ago about innovative practices with cargo trading. It was the cargo carriers who have made a number of innovations that the Japanese simply refused to allow into the trade regime because they saw immediately that this would be a competitive threat to their carriers. So they disallow the U.S. practice in order to maintain whatever competitive edge or balance there may be with their carriers. It is exasperating to me.

Mr. LAUGHLIN. Mr. Chairman.

Mr. OBERSTAR. Yes.

Mr. LAUGHLIN. May I have one additional question. Mr. Shane, does anyone in your Department or anyone at the Trade Representative's office ever give thought to telling the Japanese we're going to retaliate in some way? It just seems to me we are always giving in to them and we pack our bags and bring our rice home, we pack our airlines. Why don't we badger them a little bit? It is always one-sided, at least it certainly has that appearance.

Mr. SHANE. I don't have any brief here to talk about the rice problem, but I can tell you that packing our bags and going home in the airline business is not a strategy that we've adopted. Secretary Skinner has retaliated, as he did when it turned out that we weren't able to implement the 1989 agreement. He simply held up two services by Japanese carriers that were supposed to start up many months ago; they just weren't allowed to start, period. And there would be no starting those services until everybody was able to get all of the benefits that were meant to flow from that bilater-

al agreement. I can tell you that he would not hesitate to use any retaliatory tools available to him.

But I must say also that it was a relatively easy problem to solve with the Japanese. The fact is that the kinds of problems the Chairman has referred to are, at this point, chapters in the history of what has been a very difficult and troublesome relationship. I think at the present time it is one of our more successful relationships. Carriers have not been complaining to the Department of Transportation about their inability to do business over there. I think they are rather happy with it. We have eight carriers serving Japan as opposed to the three that are coming out of Japan to the United States. They are all going into Tokyo or into Nagoya or into Fukuoka, and they are apparently enjoying those services. Traffic has got to come back before they enjoy them as much as they would like, but I expect that to happen. And I think for the time being we are reasonably content that everybody is living up to the bargain right now.

Mr. LAUGHLIN. Thank you. Thank you, Mr. Chairman.

Mr. OBERSTAR. Mr. DeFazio.

Mr. DEFazio. Thank you, Mr. Chairman.

Mr. Shane, I have a couple of questions. I wasn't here for your oral remarks, please excuse me for being late. But reading your written testimony, on page five you talk about the enhancement—you are referring to revised policy in foreign investment benefits—and you say enhance the ability of U.S. carriers to invest abroad. I am generally skeptical of the loosening of the restrictions here. I guess I would like you tell me how it is going to enhance the ability of U.S. carriers to invest abroad? Does this mean that other countries that have government-owned airlines are going to now allow U.S. firms to purchase part of those airlines from those governments? Where is the reciprocity here? I believe we are again looking at—are there some significant concessions that are going to come or immediate changes in foreign operations as a result of allowing this increased ownership share?

Mr. SHANE. The policy initiative reflected in what Secretary Skinner announced a few weeks ago is really borne of requests that had come out of the airline industry. They were telling us, in effect, that the restrictions that are in place right now, going beyond the restrictions that appear in the law, were, in fact, getting in the way of their ability to access foreign capital markets in the way that businesses throughout the country do. It was the Secretary's view that we could very well, at least to the extent of our administrative discretion, relax those restrictions to some extent.

Congressman, you are putting your finger on an important point. If we went further than that, I guess we would want to know what the reciprocal response would be from foreign partners. No, I don't think we would be very comfortable with any kind of a policy that said foreign government-owned carriers could invest in the United States with no comparable ability on the part of U.S. carriers to invest abroad. In fact, I'm not sure we ought to have government-owned carriers investing in the United States under any circumstances, with or without reciprocity.

Congressman Clinger's bill points to another important aspect of reciprocity which I personally feel is even more important than the

reciprocal right to invest. We are just asking them to contribute money to our economy. If they are willing to do that and they don't want any money from us in their economy, maybe we shouldn't worry about what the reciprocal impact of that is. Maybe we should just take the money and run.

The more important part of the reciprocity issue, I think, is the air services part. The air services are really what have to be opened up. If U.S. carriers find themselves being invested in heavily by foreign carriers and foreign carriers are thereby enjoying the economic benefits of this wonderful market of ours, and yet U.S. carriers aren't getting into foreign markets to the extent that they want to, it seems to me that is a very lopsided picture and one that is totally unfair to the U.S. carrier industry.

Mr. DEFazio. Well, I think you are getting into cabotage and——

Mr. SHANE. No, I am not getting into cabotage, Congressman.

Mr. DEFazio. Getting into the bilaterals or the existing international——

Mr. SHANE. The ability to do business abroad in the business that they are in, yes, sir.

Mr. DEFazio. But just in terms of taking the money and run, there are a couple of other issues here. One is control. Yes, we can say, yes, the voting stock or the number of people on the board of directors. But what happens is the guy sitting next to you on the board of directors has 49 percent share and is representing a foreign carrier, then we're talking about issues that affect the competitiveness of the U.S. airline versus that carrier. I don't for a minute believe that this person will say, well, we only own 49 percent and I am going to protect your U.S. interests versus the interests of the people I work for full time and where we own 100 percent. I am very concerned about the control issue.

Generally, this whole thing of, gee, let's attract the foreign money, it is taking the money and run. Remember where the profits go. They own 49 percent of the airline; they get 49 percent of the profits. Again, it has to do with what kind of stock they bought and all these other kinds of things, but there is a concern there on-going for foreign ownership generally.

But leaving that aside, let's go to a couple other issues because I have limited time. Cabotage is a real concern of mine. I guess I can just reflect on my own very parochial part of the country. We got into this free trade agreement with Canada; we were going to get access to their market and sell them plywood and they were going to sell us plywood in return. Well, these are slightly different standards and these are builder's board rulings, and controlled by the government, and their plywood are smaller and closer together, ours are bigger and further apart, so our plywood isn't suitable for their market. So they are going to get access to 100 percent of the U.S. market, which is 10 times the size of theirs, and we've still gotten access to virtually none of theirs. That's one concern. We always seemed to get snookered in these negotiations with some sort of side note or whatever.

The second point is just the size of the U.S. market. We are the largest, most desirable market in the world. Entering into any kind of cabotage agreements, I mean we are allowing access to the most lucrative market and in return maybe we will get the Alberta-Sas-

katchewan run up there and make a lot of money on it. I don't think so. I just have a general concern about cabotage. I hope to some extent that concern is shared down at the Department.

Mr. SHANE. Yes, I think what we are doing is we are taking on the question and we're trying to take it on in a deliberate way. Nobody has signed off on any cabotage concession to Canada or anyone else. I think the proof will be in the pudding. We have to go through a negotiation to find out what's there. I know for a fact that airline labor is adamantly opposed to cabotage right now. Certainly the pilots are, although I can't speak for the other unions. We have to pay attention to what all of the parties think about that.

We will move through the negotiation cautiously and stay closely in touch with everybody, including the Congress. And at the end of the day, if it is not an agreement that makes any sense, Congress will have the wherewithal to make sure it never takes effect because we can't have a cabotage agreement, quite literally, unless the Federal Aviation Act is amended. That will be the Congress' call. In effect, the Congress will have to ratify any cabotage agreement with anyone.

Mr. DEFAZIO. Just in reflection of Mr. Laughlin's remarks, I would like to congratulate the Department and the Secretary that for once one part of the U.S. Government did get tough and reciprocal with the Japanese. It is great to believe in the ideal of free trade, but until we break down foreign barriers we are not going to make any progress. This was a case where I think the reciprocity demanded by the Secretary did, at least in this one instance, get us some results. I do look at that as a departure from a great deal of practice I've seen on the part of our trade negotiators and others over the last decade. And for that small, for once standing up to the Japanese, I do convey my thanks on the part of American workers and consumers. I just hope that we make a habit of it with everybody.

Thank you, Mr. Chairman.

Mr. OBERSTAR. Thank you.

Mr. Boehlert.

Mr. BOEHLERT. Thank you, Mr. Chairman.

Mr. Shane, the TWA proposed route sale was approved not in toto but only in part. You denied the applications for the Baltimore, Philadelphia, St. Louis to London routes. But there is a great deal of interest within the industry for those routes, is that not so?

Mr. SHANE. Congressman, we have not yet decided the case. We have issued what we call an Order to Show Cause why we should not decide it as you've outlined it. Comments are now coming in. The Secretary has yet to make a final decision, but it will be either what he outlined in the Order to Show Cause or some modification of that based on the comments. The answer to your question is, yes, the routes that are at least proposed now to be spun off of that transaction are the subject of enormous interest in the airline industry.

Mr. BOEHLERT. Secretary Skinner a couple of weeks ago testified and indicated that within 12 to 18 months we might be down from 3 to 7 major carriers. Of course, that's a concern to me and to a lot of people. Therefore, wouldn't it seem prudent, as we look at these

route sales, to consider some of the applications from the other airlines that are interested in purchasing those routes because that might strengthen them financially and, therefore, allow them to survive within the industry. Is that a factor that will be considered?

Mr. SHANE. It is a consideration we must look at. All we can do is look at the transaction that is presented, make a judgment based on the public interest, and either approve it or disapprove it, or do something in between, which is the kind of order you've seen now in the TWA-American case. If that order is finalized and the Philadelphia-London route and the Baltimore-London route are now the subject of a carrier selection proceeding, there will be the possibility of new U.S. carriers being put on those routes without any need for them to pay consideration to the previous operator of the route, TWA, at all. In other words, the franchise has been returned to the franchisor for distribution for allocation to another franchise, which will be one of the carriers that competes for that route in the proceeding before the Department of Transportation.

But I just have to underscore again, and I apologize for trying to be so legalistic about it, that we are obtaining comments right now on the Order to Show Cause. It is important that the case be kept in the proper administrative framework and decided cleanly, as it were, based on the comments that are submitted. I don't want to skew or compromise that process at all; I am just talking about the case as an example of the kinds of decisions that the Secretary makes from time to time.

Mr. BOEHLERT. Thank you so much.

Mr. SHANE. Thank you.

Mr. OBERSTAR. The gentleman from Pennsylvania, any further questions?

Mr. CLINGER. Mr. Chairman, I do.

Mr. OBERSTAR. Yes. Go ahead.

Mr. CLINGER. Given the fact that we have seen a serious retrenchment in the number of airlines and that airlines are discontinuing service on certain routes, there's a lot of interest in this committee about what can be done to encourage new entrants into the market. Is the Department presently pursuing any strategy or considering what can be done to encourage new entrants?

Mr. SHANE. Yes. The long-term strategy, which doesn't provide any short-term comfort, unfortunately, is, of course, to expand airport capacity so that the kinds of obstacles that we face at some of our more congested airports are handled and we don't find that take-off and landing slots become the ticket to new entry. As I say, that's a longer-term strategy. We had very important legislation last year which will move us importantly in the direction of expanding that airport infrastructure. So that's one important part of the equation.

Second, the Department is in the final stages of what will shortly be a Notice of Proposed Rulemaking on slots at domestic airports for, among other things, new entrants. I am hopeful that we'll be able to say more about that in the near term.

The Secretary has expressed, probably more than on any other subject in aviation, his frustration with the inability of new entrants—meaning existing airlines—to serve all parts of the country

that they wish to serve, and also with the lack of any genuine new entrants—which are new additions to the airline industry. I think he has now come to terms with the fact that there will be a continued playing out of the consolidation that we've seen in play for some time. He's convinced that there can be robust competition within a more consolidated industry. But the real challenge there is to ensure that the structure of that industry is one that enhances competition. And that means that there has to be airport access; there has to be the wherewithal of new carriers to come in to otherwise congested or concentrated airports. That's critical to the entire policy, and I think the Rulemaking will be a very important part of that strategy.

Mr. CLINGER. One of the Department's responsibilities is to select carriers to service new international routes that become available. Other factors in the service proposal being equal, does the DOT have a position on whether proceedings to grant primary or back-up authority favor an established carrier which may have experience in the industry but is struggling financially at the time, or to give preference to a new carrier which may not have any track record in terms of providing the service but has an acceptable or a good business plan as to what they propose to do? In particular, does the DOT treat proposals from proposed new entrants in the same manner that it considers proposals from existing carriers?

Mr. SHANE. Each case is commenced with what we call an "Instituting Order" and the Instituting Order lays out the kinds of criteria which the Secretary wants applied to the decision-making process; applied, in other words, to all of the competing applicants for the new route authority. Each case is described a little differently depending upon the circumstances; but I am sure I can say very comfortably, as a general matter, that the prospect of new entry is one that we always encourage and that a new entrant, someone who is not serving a particular foreign country, proposing a viable service—and I underscore it must be a viable service—probably has a leg up on the competition in that proceeding.

Mr. CLINGER. Do you tend to lean toward encouraging the new entrant as opposed to just giving to somebody who is in the business already and providing the service?

Mr. SHANE. Very much so. And in the same way, a carrier proposing to serve a community that itself does not have direct service to the foreign country involved would also bring something to the table that puts it ahead of the competition for some purposes. Then, of course, you have to go through a more complicated calculation of what the actual benefits will be. It is not that that's a slam-dunk win—being a new entrant or serving a new community—but it is certainly a very important factor in the competition that takes place within these administrative proceedings.

Mr. CLINGER. Thank you very much, Mr. Shane, for your appearance here today. We appreciate it.

Mr. SHANE. Thank you.

Mr. OBERSTAR. Can you explain to me why equity investment of 49 percent is not control?

Mr. SHANE. When you see leverage in the airline industry as high as you do today, 90 percent debt as opposed to 10 percent equity, 49 percent of the equity would be less than 5 percent of the

total capital in the company. And I think it is easy to envision circumstances in which an investor which has only 5 percent, or less than 5 percent, of the capital of a company would not be able to exercise real control.

We don't have to rely on abstractions because we have an example before us. The KLM investment in Northwest was, in fact, the investment which served as the vehicle for the Secretary making his announcement about a somewhat different spin on our administrative requirements. We have in KLM a carrier that held more than 50 percent of the equity of the new Northwest and yet, watching that combination at work for over a year and being able to say with real confidence that KLM was not exerting control—in fact, I think it is fair to say they were exerting very little influence of any kind—one could envision that the percentage of equity might be as high as 49 percent without necessarily transgressing into this impermissible area of control.

Mr. OBERSTAR. A year-and-a-half ago 57 percent of the equity constituted control to an unacceptable degree and the Department ruled that Northwest had to find a way to buy that investment down. A year-and-a-half later, suddenly that decision was changed. What other foreign carrier interests have designs on U.S. carriers with the same kind of equity investment?

Mr. SHANE. Well, I literally don't know. I guess I would say thus far we have been a little disappointed in the absolute lack of any sign of interest, despite the fact the Secretary has tried to indicate a relaxation of some of the administrative obstacles to foreign investment in U.S. carriers. Maybe it takes a while to put these deals together and maybe there is something out there, but I don't see anything.

Mr. OBERSTAR. Why would there be a rush for foreign investment, taking another aspect of this, foreign investment in U.S. carriers when those European carriers have just turned to the European Commission for financial help and the Commission, in principle, as they are so wont to do, agreed to certain steps that member countries could take to help their airlines without violating international agreements. The French have taken some initiatives already and then perhaps stepped back, although we don't know for sure, from those initiatives. What I am saying is simply if there is such a well-spring of money to be invested in the United States from foreign carriers in Europe, why are their governments busy bailing them out?

Mr. SHANE. We didn't start from any presumption that there was a well-spring of money; we just wanted to know whether or not our administrative requirements were getting in the way of any money that might be out there. I think you are quite right, it turns out that nobody is very flush right now and so the policy has not produced any avalanche of cash in the U.S. airline industry.

Mr. OBERSTAR. Do you envision any agreements with other carriers similar to the one between KLM and Northwest in which they are going to share a 747-400?

Mr. SHANE. That's not an unprecedented arrangement. I believe there are similar arrangements between Qantas and American that have been in place for years for flights between the West Coast and the East Coast. American basically carries a number of

seats that are Qantas seats, blocked out for Qantas, if I'm not mistaken. I would expect to see more of that sort of thing in the future, yes. I think to the extent that they bring efficiencies to a joint operation, enhance the presence of a foreign carrier in our market without requiring that foreign carrier in the first instance to bring its own airplanes all the way in, that those will be attractive arrangements, yes. And I think they will work in the other direction as well.

Mr. OBERSTAR. What other benefits flow to the foreign carrier in such an arrangement? Do you see any cause for concern about those types of aircraft sharing and rights sharing agreements? They are, in fact, sharing a right.

Mr. SHANE. Correct. And I think the benefits have to be seen as flowing in two directions. To the extent that they are sharing a resource, they are obviously sharing the profits from the exploitation of that resource. I wouldn't expect to see any arrangement in the marketplace that didn't offer some benefits to both participants. Maybe I'm missing the question, but it seems to me that we expect that these joint ventures will be there because they flow economic benefits to both players.

Mr. OBERSTAR. Do such joint ventures have to be negotiated or are they left to the commercial imagination of the participating carriers?

Mr. SHANE. In most cases, the latter. I think we'd be concerned about a joint venture that began somehow to compromise what we as a Government thought we were negotiating for if economic benefits started flowing to a foreign carrier whose rights were far more limited than those economic benefits would suggest. That can't happen. There's a reason why we circumscribe the benefits that are allocated to foreign carriers and we have to keep our eye on that ball.

Mr. OBERSTAR. The latter point is where I'm headed with my questioning. What are the limits then to this innovation?

Mr. SHANE. It is hard to say in the abstract, Mr. Chairman. I think we just have to keep our eye on these arrangements and understand as fully as possible what kinds of effects they are having on, again, the negotiating process; the maintenance of leverage being the most important consideration.

Mr. OBERSTAR. You satisfied, in part, my curiosity and my concern by expressing the Department's awareness that there could be implications that would be injurious to the bilateral.

In testimony we are going to receive on Thursday, we will have some carriers saying that DOT route award policy does not encourage new entrants. The case of Baltia Airlines, for example, in its application for routes to the Baltic States, the Administrative Law Judge said that Baltia's application was better but the carrier lacked experience. The route was recommended for the other carriers. That reflects the ALJ thinking. How does that, or does that, reflect Departmental thinking, the Secretary's views? I don't want you to comment on the specific case, but I cite it because it is the most recent and it does block a so-called new entrant. If your policy is to encourage new entrants, why wasn't this one encouraged?

Mr. SHANE. I indicated that it is impossible to be very general in your pronouncements about policies of that kind. There isn't any

question that the Department is generally interested in seeing new entrants come into these markets. That doesn't mean, as I said in response to Congressman Clinger's question, that the very fact that you're a new entrant entitles you to a slam-dunk win in a proceeding of that kind.

The Administrative Law Judge sends a recommended decision, not a final decision, to Mr. Murphy, and it will be Mr. Murphy's decision in the final analysis. I don't even know where that particular case stands in the process at the present time. But I think what Mr. Murphy must ultimately consider is whether or not there is enough question about the wherewithal of this new entrant to mount a successful service to justify overcoming the presumption that might otherwise—it may not be a legal presumption, but some kind of a moral presumption that would favor a new entrant's application in a case of that kind. I don't want to comment on that case, and you'll understand I am not commenting on it.

Mr. OBERSTAR. I don't want you to comment because I realize the complexities. But the point is that our policy is to encourage new entrants. Here's a new entrant, bona fide, trying to serve—and this is a very interesting area which got my interest up because we have all of the development in Eastern Europe—Poland, Hungary, Romania, Czechoslovakia, and Bulgaria—with opportunities there for future service for the United States and where a new entrant of this very type, originally a national of the country, now an Americanized citizen, wants to serve his homeland. We may find that same kind of things with the other East European countries and here, for what seemed to be rather curious grounds, the application was denied. And if every new entrant has to be experienced, how are you going to get a new entrant? How many new entrants, in fact, have there been approved for international route service?

Mr. SHANE. Well, I am not sure I know without going back and checking the records.

Mr. OBERSTAR. If it doesn't jump to mind, then there aren't very many.

Mr. SHANE. Quite right. And I don't mean to suggest that we have a policy opposed to new entrants. It may very well be that a particular new entrant just doesn't satisfy the Department of Transportation or the Administrative Law Judge or anybody else that has to look at it that it is capable of exploiting international route opportunities as fully as the American public would want them to do. That has just got to be decided on a case-by-case basis.

Mr. OBERSTAR. If we are going to stimulate competition and sustain competition to provide consumers the benefits of competition—lower fares, better service, more opportunities—then there have to be some policy guidelines for new entrants. What do they have to do?

Mr. SHANE. Well, they have to be—

Mr. OBERSTAR. They have to have a good business plan. They have to be financed. They have to meet the "fit, willing, and able" test. And then what?

Mr. SHANE. And then, if we are talking about a competitive route proceeding, a carrier selection proceeding before the ALJ and Mr. Murphy, then they have to demonstrate that their proposal will result in greater economic benefits coming from the exploita-

tion of a particular international route than that offered by the competitors. And I indicated that they would probably come in to the proceeding with a leg up on the competition by virtue of their new entry status. That's important to us. But if the calculation results in dramatically less real benefits coming into the United States as a result of putting a new entrant on the route, then that leg up might be overcome by the need for the most productive possible use of that resource. It is just very difficult to say in the abstract how a particular case would come out.

Mr. OBERSTAR. Does the ALJ consider the competition this new entrant may encounter from a foreign source?

Mr. SHANE. Sure. Competition in the operation of the international services.

Mr. OBERSTAR. Right. Right. And would that be a factor then for the ALJ in making a decision that our proposed carrier is not as experienced as another carrier so we'll look for a more experienced U.S. carrier to compete with this more experienced foreign carrier?

Mr. SHANE. Well, again, difficult to describe in the abstract. I don't think the mere inexperience of a carrier is going to be, or ought to be, a major factor in an assessment of whether it could compete.

Mr. OBERSTAR. That's a very good policy statement.

Mr. SHANE. New carriers compete very excitingly and very successfully with older line carriers, and we've seen that time after time. But I guess I feel like I am getting onto delicate ground because I don't know exactly what happened in the case that we're talking about. I don't know where it stands in the procedure and it seems to me that whatever I say can be construed for or against various parties in the case.

Mr. OBERSTAR. I realize it is very delicate ground, but I am attempting to explore a policy area that I think is very important for the future. We see more and more U.S. carriers going out of business like an experienced carrier, Pan Am, losing its shirt and a lot else, and its parts being parcelled out to other carriers, and here is a new entrant with admittedly a good business plan but no experience. What do you want? What does our policy encourage? An experienced business carrier with poor business operation or an inexperienced new entrant with a good business plan? That's the policy dilemma here and I urge you to think it a little further in the Department and the ALJ to think about it.

How do you measure the success of policy and approach in the negotiation? I think my colleagues on the committee receive fewer complaints today than we did five or six years ago. I think there is less complaint about "doing business" issues, although they continue to hamper us in the Japanese trade and we still have some problems internally in Europe with those matters. There is not a deregulated environment in Europe of which we can fully take advantage of our trade opportunities. How does the Department of Transportation assess your progress towards a liberalized regime and what groundwork are you laying in this longer term for the future to stimulate that more liberalized regime in Europe, for example?

Mr. SHANE. I guess the first part of the answer has to be that it has become clear that the success of any airline in our market is

going to be in a large part a function of its ability to succeed in international markets. I think we have learned through the course of this deregulation of ours that in order to really be a competitive player in this market you have to have a successful domestic operation conjoined with a successful international operation. So as the Secretary reviews the kinds of transactions that have been coming at us thick and fast over the past few years in which routes are being redistributed through the private sector, the private transaction process, it is very important that we keep our eye on that ball and understand that the competitive structure of the market is in many ways going to be a function of how the Secretary decides those cases.

And so making sure that, whatever number you end up with, it is not ours to decide, but whatever number of carriers you end up with, each of those carriers is going to be a robust player in the market, competing both for domestic traffic on a national basis, or largely national basis, and competing effectively for a good share of the international traffic that's out there. If you have that kind of an industry, then you are ready for anything, as it were.

Then you move into the negotiating process. You either negotiate with the European Community or with ECAC or with whatever forum you can establish and begin to sort out how, in fact, you can expand those opportunities to a greater extent than they exist today. We are beginning to see through the bilateral process some interesting moves in that direction; the first one being Canada, and the kinds of concepts that will at least be on the table in those Canadian negotiations. Those may very well end up setting a trend for other bilateral negotiations that take place, not just between the United States and its partners, but Canada and its partners and between other foreign countries. It is hard to say how that ultimately will play out.

We have bilateral conversations going on, as I said, with a whole host of our European partners. Now that we have the Heathrow problem behind us, we are looking forward, in fact, to having talks with the United Kingdom which will be for the purpose of seeing to what extent this market between the United States and the U.K. can really be liberalized. There is nothing very liberalizing about the agreement that we just did on Heathrow. Contrary to some of the things that I've heard here this morning, I regard that as essentially garden variety stuff, with the possible exception of some opportunities that the U.K. would have coming from other European countries to the United States, and we can talk about those in a moment. My assessment of the U.S.-U.K. relationship, given the policies of these two governments and our preference for free trade regimes, is that it is essentially a disappointment. It has to be seen as a disappointment. It is the biggest overseas aviation market that we have in terms of enplanements and yet it is still governed by a highly restrictive regime which is not any less restrictive by virtue of what we did with the U.K. in the past few weeks.

So I am looking forward very much to sitting down with the United Kingdom and talking about how we might liberalize a very healthy portion of the transatlantic market and how, indeed—and this is part of the conversation that we have yet to have—how the United States and the U.K. together might be able to engage some

of our other European partners in a very interesting conversation about what this transatlantic market is ultimately going to look like. It may be that we end up having to get ahead of any conversation we might have with our friends in Brussels simply because the EC is on a slower track. I have no idea. That might be treated in the U.K. as absolutely pie-in-the-sky stuff and maybe they have no intention of having that conversation with us at all. But I think we should have that conversation. It would be intriguing. We both have the policies and we both have the kinds of airline industry that ought to be able to move aggressively into the rest of Europe and the rest of the world and perhaps reinvent this global system of rules and regulations at long last.

Mr. OBERSTAR. That's a very good and strong and encouraging viewpoint. On measuring success, do you consider percentage of market share to be a measure of success, in cargo and in passenger market share? And what statistics is the Department keeping on this subject? They were rather weak on that a few years ago.

Mr. SHANE. We keep market share statistics on every bilateral market that we trade in, both cargo and passengers. I would be happy to supply those for the record. I can say just in general that at this particular moment in our history, U.S. carriers have slightly more than half of the traffic flowing to and from the United States from all points. Not to say that we are winning, if you use market share as a gauge of winning, in every single bilateral market. There are some which U.S. carriers don't propose to serve very effectively. The U.S.-Netherlands market is a classic example where KLM has I think 85 or 90 percent of the traffic, maybe more than that, not because they are keeping U.S. carriers out but because U.S. carriers choose to target other destinations in Europe. They can go into the Netherlands with all the carriers and all the capacity they want without anybody's permission.

So there are differences in different markets. But by and large, I think it is a success story that most other American industrial sectors ought to envy.

[The following was received from Mr. Shane:]

TABLES SHOWING THE U.S. FLAG SHARE FOR INTERNATIONAL PASSENGER AND FREIGHT OPERATIONS ON A REGIONAL BASIS AND FOR THE TOP 25 MARKET COUNTRIES

The following tables show the U.S. flag share for international passenger and freight operations on a regional basis and for the top 25 country markets. The passenger information, derived from the Immigration and Naturalization Service I-92 reports, compares the U.S. flag share for the 12 months ended November 1990 with the 12 months ended November 1989. The freight information, obtained from Bureau of the Census' Foreign Airborne Trade Data, compares calendar year 1990 and 1989 statistics.

Unfortunately, the Airborne Trade Data for 1989 and 1990 contain structural difficulties and we do not recommend that much reliance be placed on its validity. In 1989, the Bureau of the Census, in the interest of economy and standardization, made several changes in the format and procedures regarding the collection of the foreign trade statistics. When it became obvious that there were difficulties with the statistics, the Bureau made adjustments to increase their accuracy. These adjustments, however, were not applied to the foreign airborne trade data, which represents only a small fraction of the overall foreign trade statistics. We would also note that the Canadian airborne trade data has additional problems during this period because of a basic change in reporting.

The Department of Transportation instituted the new "T-100" reporting system last year, effective January 1, 1990. When information collected through this system has been processed and edited within the next 2-3 months, we will be able to develop complete calendar year 1990 passenger and cargo market share information based on it.

Table A shows that from 1989 to 1990, the U.S. passenger flag share increased in six of eight regions, was constant in one (Central America and Mexico) and declined slightly in one (Europe). In 1990, the U.S. flag share was above 50 percent in four regions. For all regions, the U.S. flag share increased from 51 percent in 1989 to 52 percent in 1990. Table B shows the United States' top 25 country markets in passenger volume and the U.S. flag share.

The air freight statistics are grouped into seven regions (see Table C). Although the U.S. flag share increased in only three regions from 1989 to 1990, the overall U.S. flag share increased. In 1990, the U.S. flag share of the air freight was above 50 percent in two regions - Canada and Australia/Oceania. Table D shows the United States' top 25 country markets in air freight tonnage and the U.S. flag share.

Table A

PASSENGER TRAVEL BETWEEN U.S. AND WORLD REGIONS

Year Ended November 1989 and 1990

	<u>U. S. Flag Share (%)</u>	
	<u>YE Nov. 1989</u>	<u>YE Nov. 1990</u>
ALL REGIONS	51	52
Central America and Mexico	52	52
Caribbean	68	70
South America	40	43
Europe	47	46
Africa	4	6
Middle East	22	25
Far East	49	53
Oceania	56	61

Source: DOT/TSC Database

Table B

**PASSENGER TRAVEL BETWEEN U.S. AND OTHER COUNTRIES
TOP 25 COUNTRIES**

Year Ended November 1989 and 1990

Rank	Country	U. S. Flag Share (%)	
		YE Nov. 1989	YE Nov. 1990
1	United Kingdom	51	48
2	Japan	55	58
3	Mexico	55	53
4	Germany - West	51	51
5	France	64	75
6	Bahama Islands	74	70
7	Jamaica	37	49
8	Dominican Republic	77	84
9	Netherlands	14	19
10	Italy	54	54
11	Korea - South	33	47
12	Neth. Antilles	79	78
13	Switzerland	36	30
14	Scandinavia	46	39
15	Brazil	42	46
16	Spain	48	54
17	Australia	52	59
18	Venezuela	52	53
19	Belgium	47	52
20	Bermuda	94	94
21	Ireland	21	20
22	Hong Kong	59	67
23	New Zealand	73	61
24	China/Taiwan	11	27
25	Guatemala	58	59

Source : DOT/TSC Database

Table C

AIR FREIGHT TONS TRANSPORTED
BETWEEN THE UNITED STATES AND WORLD REGIONS

Calendar Years 1989 and 1990

Region	U. S. Flag Share (%)	
	<u>C.Y. 1989</u>	<u>C.Y. 1990</u>
Canada/ Greenland	47.9	57.4
Latin America	36.0	36.9
Europe	29.4	28.0
Middle East	8.2	7.6
Australia/ Oceania	50.2	50.6
Africa	16.2	13.0
TOTAL	35.7	36.3

Source: Department of Commerce, Bureau of the
Census, Foreign Airborne Trade Data

Table D

FREIGHT TONS TRANSPORTED
BETWEEN THE UNITED STATES AND THE TOP 25 COUNTRIES

Calendar Years 1989 and 1990

Rank	Country	U. S. Flag Share (%)	
		C.Y. 1989	C.Y. 1990
1	Japan	47.0	45.1
2	United Kingdom	51.2	45.1
3	West Germany	22.7	23.5
4	Colombia	27.7	30.1
5	France	33.6	31.5
6	Italy	24.1	23.3
7	Taiwan	55.1	48.6
8	Korea	38.1	42.3
9	Hong Kong	51.3	53.7
10	The Netherlands	16.3	17.3
11	Singapore	35.2	35.7
12	China	48.1	53.5
13	Brazil	40.6	41.8
14	Switzerland	20.9	18.9
15	Belgium/Luxembourg	18.9	21.2
16	Mexico	52.4	55.4
17	Australia	49.0	50.4
18	Costa Rica	59.6	54.4
19	India	21.2	16.8
20	Venezuela	40.1	32.4
21	Dominican Republic	24.0	40.9
22	Spain	19.2	21.4
23	Sweden	13.6	18.7
24	Chile	17.6	16.2
25	Israel	10.7	9.0
Top 25		37.1	36.1

Source: Department of Commerce, Bureau of the
Census, Foreign Airborne Trade Data

Mr. OBERSTAR. That's one reason I feel very strongly about the bilateral negotiating regime, that it does give us the opportunity to insist on that equity of opportunity with our trading partners.

I see a trend toward cross-investment among European carriers. More is occurring and perhaps the difficulties created by the Gulf War may accelerate that trend. I think there may be even more occurring as Europe finalizes 1992. Certainly a liberalized regime on cabotage within Europe would even further, in my judgement, accelerate that practice. France has now just about completed a consolidation with the three carriers virtually combined into Air France. Do you follow these trends, and what opportunities do you see unfolding among European carriers for that kind of further cross-investment consolidation?

Mr. SHANE. That's always been intriguing to me. I anticipated some time ago that you would begin to see real consolidation taking place within Europe, particularly as the liberalization process moved forward. I still think you'll see it, although the precise form that it takes is not exactly clear. I indicated earlier that I think that the concept of national flag may be a diminishing element in the aviation policies of a lot of European countries. I don't think at the end of the day you won't have carriers flying around as the national carriers of particular countries. That will probably be necessary for a while longer. But the national carrier of country X may, in fact, be a subsidiary of a multilateral corporation which has a number of subsidiaries being a number of national carriers, so that you are really dealing with a few corporate entities which are running the airline business within Europe.

If that's the case, if you move in that direction—and certainly the economics of the business have moved the U.S. carrier industry in that direction and I wouldn't see any reason for it to move in any different direction in Europe—then it seems to me that the process of negotiating with foreign governments ought to be easier. In other words, to the extent that the negotiations have been made more difficult by the need of each government to ultimately protect its national carrier, because it really was a national carrier and because it was essentially based on an inefficient arrangement of route opportunities, it has always been a very difficult exercise to open up the market to a greater extent. I am surprised that we have been as successful as we have been.

Air France is consolidated and you would have expected that now Air France would be a much stronger carrier, and, yet, in our last negotiations with France, we had to make concessions in order not to scare the bejesus out of Air France with the fact that we have eight carriers flying to that country against Air France right now. So we have to pay attention to these markets to a greater extent than you'd want to just because national carriers are sort of inefficient animals.

The European integration, the single market process, I hope, will move each of these governments away from the notion that it has to have as an expression of its nationhood an airline flying its flag around the world or it is not a real country. The days for that sort of luxury are over and I think once the EC single market process moves in that direction, I think we will have a much more exciting time negotiating with our European friends and I think the trans-

atlantic market will be a much more interesting market. I would expect U.S. carriers to become very important players in the European market over time by virtue of the fact that the negotiating process will move us in that direction.

Mr. OBERSTAR. That's a very wholesome view and one that I share and an approach that I share. I want, however, to keep the pressure on the European Community to continue to divest itself of these barriers to free trade, liberalized trade, and also to modernize their own air traffic control system. I don't think that it is quite right for the European carriers to look forward with great anticipation, as they do, to increasing access to the United States with the most modern air traffic control system, with the billions that we're spending—what are we spending, \$25 billion over the rest of this decade—modernizing air traffic control, probably \$50 billion in improving airport runways and taxiways and modernizing the terminals, and they are doing relatively little in that regard. They have an antiquated air traffic control system. They can come to the United States and take advantage of the billions of dollars of our investment and compete with us in this country while we go into their infrastructure which is antiquated, out of date, and encrusted with protective barriers for their carriers. My message to Karel Van Miert and others in the EC is shape up, modernize, give us an opportunity to compete in your turf with the same tools that you will be able to take advantage of in the U.S. turf.

Testimony we are going to receive later describes a problem of restricted category aircraft being used in commercial operations. This is a matter of real concern to me. The C-130 aircraft, which the military divested itself of, got through the Department of Agriculture to use in firefighting, and now suddenly they are turning up in international trade and charter operations. I find that absolutely astonishing. What is the Department doing about this?

Mr. SHANE. Well, we share your view. Those airplanes have no business being in the commercial marketplace whatsoever, and there are supposed to be restrictions, covenants attached to the documentation of those airplanes that will keep them out of commercial air service. I am personally grateful to Southern Air Transport and to NACA and Ed Driscoll for bringing this problem to our attention. They have, in effect, monitored the movement of some of these airplanes into the commercial marketplace in violation of all the rules which apply.

The Department of Defense has some opportunities to help us out on this front. We have had some conversations with DOD but thus far I think we haven't really solved the problem entirely. It is something that does require our attention. I am equally determined to see these airplanes out of the commercial market where they were not intended to be. They are not commercial entities and it is entirely unfair to U.S. carriers that play by the rules, buy their airplanes in the commercial marketplace, to find themselves in competition with airplanes that have been picked up, in effect, as war surplus or government surplus—because they were not licensed for commercial operations, that's why the price is as low as it is—repainted, and then put into commercial service. It is just not—

Mr. OBERSTAR. They aren't even certificated by the FAA for such service.

Mr. SHANE. Correct. The FAA is very concerned about it.

Mr. OBERSTAR. Well, let us join forces to achieve fairness and equity.

Mr. Packard.

Mr. PACKARD. Thank you very much, Mr. Chairman.

It is obvious that it is difficult for me to wean myself away from this subcommittee. I have enjoyed serving on it for so long and I have gotten involved in aviation issues, now I no longer serve on it, but I do appreciate the chance to come back occasionally.

I had some questions that I particularly wanted to come and ask, Mr. Shane, regarding foreign ownership in our airlines and air companies. The limitation of 25 percent of a U.S. carrier stock purchased from a foreign airline, would the Department of Transportation allow that foreign airline to own that level of stock in one of ours if it is a foreign government owned airline?

Mr. SHANE. At this point, I don't think the law says anything about that. I might want to get back to the record with that answer because I don't think there is any wherewithal right now in our rules or regulations that enables us to distinguish between a government-owned foreign entity and a non-government-owned foreign entity.

Mr. PACKARD. My concern, of course, is if a foreign government owned airline came in with 49 percent participation or even 25 percent, it could use that as leverage in non airline international relationships and perhaps abuse that ownership, allowing a government to be injected into our aircraft industry and our airline industry rather than just another airline from a foreign country. I would appreciate an answer as to whether there are any restrictions on Government ownership of an airline participating in a domestic airline.

[The following was received from Mr. Shane:]

There is nothing in the Federal Aviation Act that specifically restricts or limits a foreign government owned entity from investing to a greater extent than a foreign privately owned entity in a U.S. airline. As you know, however, we have consistently maintained that the Act requires that U.S. carriers actually be controlled by U.S. citizens. Under the control test, if we find that, by virtue of foreign government ownership, a particular entity seeking to invest in one of this country's carriers could exert an unacceptable degree of influence over the carrier, either directly or through a bilateral negotiation process, we certainly do factor this into our decision on whether to condition, limit, or disallow such investment. In the cases involving KLM's purchase of an interest in Northwest and SAS's purchase of an increased stake in Continental, a number of conditions were agreed to by those parties including a proviso that any directors representing the foreign carrier interests would recuse themselves both from participation in bilateral or multilateral negotiations and other specified matters and that they would not receive documents relating to these matters which would not otherwise be available to the foreign air carrier. These conditions illustrate how conditions or limitations can be designed on a case by case basis to address specific control problems.

Mr. PACKARD. Does the size of a U.S. airline to be acquired by foreign airlines make any difference to the Department of Transportation in the acquisition of stock interest greater than 25 percent? In other words, is there a difference between a giant airline and a small airline, where you only have a very few—maybe two or three, four or five—aircraft in a company? Are the policies differ-

ent in foreign ownership between a United or an American versus a small company that is just getting started or with a few aircraft?

Mr. SHANE. First of all, the 25 percent stock ownership is an absolute ceiling. That's in the law and we can't ever go over that. So I think the question is would we look less favorably on a 25 percent investment in a small carrier than in a large carrier, if I understand the question.

Mr. PACKARD. Well, I believe that there are some circumstances where foreign ownership could go as high as 49 percent; is that correct?

Mr. SHANE. Forty-nine percent of the equity of the carrier provided that the equity is taken in non-voting stock.

Mr. PACKARD. I see. I appreciate that clarification.

Mr. SHANE. We don't have a very clearly spelled out policy that would distinguish between large U.S. carriers and small U.S. carriers in terms of how you would look at a particular investment. The assumption is that 49 percent of equity, provided that there are no other indicia of control, regardless of the size of the airline in question, would not bar the investment in question. If upon examining a particular transaction, whether or not it is because of the size of the airline that is proposed to be invested in, one gets the suspicion that there may very well be control, then it is possible that you would say that because law does prohibit control, it is not a U.S. airline because foreign nationals controlled it. That investment—even though it is under the 25 percent voting stock and even though it is below 50 percent of the equity all totalled—that transaction nevertheless came too close to control. But it is very hard to offer you an abstract opinion on something like that.

The reason the Secretary has thus far resisted a number of entreaties to write it all down in a rulebook is that he is absolutely convinced that the moment we write down a set of rules, highly paid lawyers will come in and figure out exactly how to get around those rules. There is never any success in trying to anticipate every transaction. So we continue to do a case-by-case process. I think we just have to be aware of when control is there; that is the ultimate question.

Mr. PACKARD. Foreign ownership in a very small company could gain control sometimes a lot easier than they could in a bigger company; and in some instances the opposite would be true.

Last question, if I may, Mr. Chairman. What effect does ownership by a foreign airline in a U.S. airline up to 49 percent, or at least greater than the 25 percent, have on by-passing the bilateral negotiating process with a foreign country?

Mr. SHANE. That's a very important question, Congressman. If a foreign investment got in the way of the kinds of opportunities we were seeking to extract through the bilateral negotiating process, then it would present us with important policy problems. It would present those problems, it seems to me, however, only if there were an opportunity for the foreign investor, the foreign carrier, to exercise that control which, under the law, is impermissible. So to the extent that we are talking about levels of investment that are entirely within the framework of there being no control by a foreign entity, I think the bilateral process remains intact; I don't see it being compromised in any significant way.

By and large, the investments that we have seen to date have come from partners who have not had a lot more for us in the bilateral negotiating process. That may be a different story if the U.K., for example, comes in with large proposed investments in U.S. airlines because there are obviously things that we're seeking in our bilateral negotiations with the U.K. which we don't have yet. I think we would want to keep our eye very closely on the impact of those investments on the bilateral process and ensure that we aren't being compromised at all in the kind of negotiating leverage we have to have.

Mr. PACKARD. I would appreciate it if you would give me some further information on the foreign government owned operators investing.

Mr. SHANE. I will do that.

[Information received from Mr. Shane follows:]

Only a few foreign air carriers with a significant degree of government participation hold investments in U.S. airlines. In addition to the KLM and SAS holdings we have already discussed, these include investments of Swissair and Singapore Airlines of 5 percent each in the stock of Delta Air Lines, an investment by Lufthansa of under 2.5 percent in the stock of DHL Corporation and up to 25 percent of a related company, and an option of EL AL Israel Airlines to purchase up to 24.9 percent of the stock of North American Airlines, Inc.

Mr. PACKARD. Thank you very much, Mr. Chairman. I appreciate it.

Mr. OBERSTAR. I would like to follow up on that matter of restricted category aircraft. I said we should work together. Perhaps it would be useful if you coordinated a gathering of the responsible Federal agencies to meet with the subcommittee in the near future to discuss steps that can be taken to end this practice that is so offensive.

It seems that the Department in the U.K. Heathrow agreement is setting the stage for larger investment for this globalization—or, perhaps, Europeanization—that is already de facto taking place by one element of the agreement under which U.K. airlines—if I have the language accurately from the agreement—can own up to 50 percent of another EC airline and the United States will not question the nationality or control of the EC airline based solely on U.K. ownership. That is a major step forward, is it not, in this globalization, in this cross-investment? It seems also to be an important linkage between that language and the successor question that the U.K. was so insistent on, that there could be no entrance to Heathrow unless there were a successor carrier that acquired entirely those that had rights. It seems to be a significant concession.

Mr. SHANE. Each bilateral agreement specifies that the airlines that are allowed to operate under the bilateral agreement must be substantially owned and effectively controlled by nationals of the contracting party from which they are flying. If we are talking about Belgium, for example, and the United Kingdom proposed to buy 49 percent of Sabena or another Belgian carrier, and then the Belgians sent a diplomatic note to the United States designating that carrier for service to the United States, we would want to ask under normal circumstances is that carrier substantially owned by Belgian nationals. To the extent that the U.K. interests have 49

percent, we would say, yes, 51 percent are owned by Belgian nationals.

Then the question would be effective control. The control question I suppose could be addressed very much in the way we addressed the control question in the context of foreign investment in U.S. airlines. We would have the wherewithal under normal circumstances to say to Belgium, sorry, that airline looks to us like it is being controlled by U.K. nationals not by Belgian nationals, and therefore we don't want to see it in our market.

What we have said to the U.K. in this agreement is we won't interpose that objection if it is an airline that is substantially owned by Belgian nationals or the nationals of whatever country we're dealing with, and it looks as though you have a substantial investment in it—you, the U.K., have a substantial investment in it. We will not object to it by virtue of that substantial investment alone. It is still a Belgian carrier and I presume it is still a Belgian carrier under Belgian law. So we haven't changed things that dramatically. The fact is, though, that by not objecting on the basis of effective control, we certainly are providing a new opportunity to the United Kingdom to begin to search for partnerships of that kind throughout Europe, there's no question.

I don't know, frankly, how many of those transactions are expected to take place in the near term. I know that those are aspirations that we've heard Lord King talk about from time to time and British Airways has talked about them. But, yes, it is a new opportunity—an opportunity that we would not have been particularly obliged to entertain prior to this last agreement.

Mr. OBERSTAR. Yes. Now, what precedent does this set for SAS that is interested and is aggressively investing elsewhere? What precedent does it set for let's say the bilateral with Germany, where you have Lufthansa aggressively investing?

Mr. SHANE. It is a precedent in terms of major partners. It is not a precedent in terms of other partners. There are a number of so-called national airlines owned by nationals of other countries and typically the United States, where there hasn't been any particular reason for objecting, typically the United States does not object. In fact, I'd be happy to supply a few of those for the record. The point is that every country believes that it ought to have a national carrier; that's the view—I'm thinking of Latin America as much as anywhere else in the world. And in the context of developing economies, particularly, if it is necessary to get some foreign investment into a national carrier in order to ensure that there is a national carrier in one of those countries, the United States would not object and has not objected, despite the fact that it legally has the right to object because it is not a carrier substantially owned and effectively controlled by nationals of that particular country; it is substantially controlled by somebody else.

[The following was received from Mr. Shane:]

In a number of cases, most notably those involving airlines of the Caribbean and South America, the Department has waived its ownership and control standard (49 U.S.C. 1378) where we determined that there was nothing in the ownership of the foreign carrier which would be inimical to U.S. aviation policy or interests. A few examples follow: Aerolineas Mundo, S.A. T/A AMSA—a flag carrier of the Dominican Republic (12% of capital stock held by a citizen of the United States); Aviateca, S.A.—a flag carrier of Guatemala (30% of capital stock held by TACA International

Airlines, S.A., the flag carrier of El Salvador); Aerolineas Centroamericanas, S.A. d/b/a Central American Airlines—a flag carrier of Nicaragua (26% of capital stock held by citizens of Italy and Greece); Air Antilles Limited—a flag carrier of St. Lucia and Grenada (30% of capital stock held by citizens of Barbados and Jamaica); Traslados, S.A.—a flag carrier of Guatemala (45% of capital stock held by a citizen of West Germany); Spanair, S.A.—a flag carrier of Spain (49% of capital stock held by a citizen of Sweden).

Mr. OBERSTAR. We may look back two years from now or three years from now and say this was the agreement that did for Europe what Europe perhaps was not able to do for itself.

Mr. SHANE. I would like to think that it mixed it up a little bit within Europe. We are not seeing the kind of progress I think, Mr. Chairman, that you and I had hoped to see within the European Community, and for reasons that can be completely understood. It is not an easy process to forge one policy out of all of those policies. But there isn't any question but that there are two features of the agreement with the United Kingdom that do raise interesting questions about how the Europeans will deal with each other. One of them is the one that you cite. And the other one is the opportunity which U.K. carriers will have to fly to the United States directly from a variety of specified European destinations. That's been dubbed a "Seventh Freedom Right." There is no such thing as far as I am aware of as Seventh Freedom in the typical parlance, but it is a shorthand for the ability of a foreign carrier to come to the United States from a third country without going back through its home territory, as is normally required under international law.

Of course, when British Airways or any other U.K. carrier seeks to operate to the United States from France, for example, it will need not just U.S. permission, it will need French permission. And what is interesting to think about is what the French will seek from the U.K. in return for its willingness to allow British Airways to operate between Paris or anywhere else and some city in the United States. It is not impossible that they may seek the right to operate as Air France between London and the United States, for example. If that's the case, guess who gets to decide once again whether British Airways will finally be able to operate between France and the United States. It will be the United States, because it will be up to us to decide whether or not France can operate between London and the United States. So we've started a round robin here.

What is fascinating to me, I don't think there is an enormous amount of economic opportunity out there for British Airways through this new concept or this new right. What there is is an opportunity; an opportunity to really begin some round robin discussions to figure out exactly how all of these opportunities can be expanded so that British Airways can take advantage of an opportunity of that kind and that other countries can, and that the United States will benefit as well.

Mr. OBERSTAR. When actions such as those the EC took recently occur, what is the policy of the U.S. Government—since we're not involved in direct investment in shoring up our carriers, and the modest proposal I offered the Secretary with regard to suspending 2 percent ticket tax for a time to relieve some of the burden on our carriers since they are so crucial to the Gulf War, to the airlift into and now the airlift out of the Gulf region—but when the Govern-

ment of France offered some \$400 million to Air France to help it through the hard times, isn't that a competitive problem?

Mr. SHANE. It would be a competitive problem if we were dealing with a carrier that constituted a competitive threat. I mean, our problem with Air France is that we can't keep them robust enough in our market; they are down to about a 30 or 35 percent market share now. I don't think we need to worry about an investment by the French Government in Air France in the near term. It is important that Air France stay alive or the health of the relationship with France in aviation is not going to be intact.

Mr. OBERSTAR. I understand that with respect to Air France. My question is with respect to the policy.

Mr. SHANE. The policy is essentially addressed, as I understand it, to internal European operations. Those are the ones for which Brussels has jurisdiction. Those operations have never been characterized by enormous amounts of competition. That's what is so exciting about the single market phenomenon; they are finally bringing some competition in to these internal routes for the first time. I see it as a temporary pause, if you will, in the movement toward a liberalized market. Again, the internal markets within Europe are not markets that we are very big players in in any event. They aren't putting those special suspensions of the rules in place in markets to and from the United States; those will be governed by the rules which have always governed them.

Yes, certainly to the extent that it provides a little bit of comfort and a little bit of a cushion for the European carriers, I suppose you could characterize it as providing some kind of a competitive advantage to the extent that those carriers do operate in our market, do compete with U.S. carriers in the international or transatlantic market. But I frankly don't think it is a major concern here. They have raised it with us; they haven't brought it to our attention as though it was something that needed to be dealt with on any urgent basis. If, in fact, they have a different view, I would like to hear it because we would be happy to take that up. We have certainly allowed our European Commission friends to understand that we aren't very comfortable with the idea of that being a policy that would come into place every time there is a little bit of a hiccup in the market.

Mr. OBERSTAR. And I think the EC was very uncomfortable with this whole process itself.

Mr. SHANE. I think they were.

Mr. OBERSTAR. I won't pursue that further. I will ask you to submit in writing to the committee an explanation of the DOT's policy of "Fifth Freedom Charters," specifically why the Department considers them to be in the public interest.

[Information received from Mr. Shane follows:]

Under Department rules, a foreign airline holding underlying charter authority from us may normally operate Third and Fourth Freedom charters (that is, charters between the United States and its homeland) without prior Department approval. The operation of Fifth Freedom charters (charters between the United States and a point not in its homeland) requires prior approval on our part for each flight or series of flights. The regulatory standard for the grant of this authority (called a "statement of authorization") is a finding that the proposed operation is in the public interest.

In determining whether to approve applications for Fifth Freedom charter authority, we look at a broad range of factors affecting the public interest. These include reciprocity for U.S. carriers, the needs of the charterer involved, the balance of aviation benefits in the bilateral relationship, the extent of the applicant airline's reliance on Fifth Freedom operations in relation to its homeland-U.S. services, and our desire to strengthen opportunities for U.S. carriers in homeland markets of applicant foreign airlines. We also consider, where appropriate, certain other public interest factors, such as the Administration's goal of promoting the interests of developing Caribbean countries; the need of certain foreign airlines to secure subservice, through wet-leases, to maintain their homeland-U.S. operations; and the interest that a U.S. airline may have in providing the charters involved and the reasons why that interest should receive special consideration. Finally, certain other ad hoc factors may enter into our decision, such as those indicating a hardship element favoring approval (for example, stranded passengers or perishable cargo).

While any individual factor might take on greater or lesser weight depending on the circumstances of a particular case, we generally look first to reciprocity. We expect that the applicant's homeland government will grant U.S. airlines operating privileges comparable to those being sought by the applicant. Where we have established that reciprocity is lacking, foreign airlines can expect that their applications will be denied. (Indeed, our clear policy in this regard discourages such airlines from applying for operating authority.) Where we have not established that reciprocity is lacking, but have received allegations from U.S. airlines raising the issue, we investigate those allegations and consider the resulting findings in evaluating the application.

We also give great weight to the charterer's choice of airline. In keeping with the Administration's goal of minimizing government interference with the public's business judgments, it has been our practice to give charterers the maximum flexibility possible to choose the airline which best meets their needs, and

to interfere with that choice only when the public interest requires. We believe that this practice, and the resultant additional competition provided by foreign airlines, has greatly enhanced the price/service options available to the public, benefitting tour operators, shippers, importers and exporters, and the consuming public at large.

In addition, we examine the balance of overall aviation benefits in our bilateral relationship with the applicant's homeland. There are a number of countries, most in the Caribbean, served by U.S. scheduled airlines (often on a daily basis, with widebodied equipment), that do not have major airlines of their own. These countries often have small cargo airlines which file requests to operate Fifth Freedom charters. Any attempt to impose new limits on their operations could have an adverse impact on the much more valuable access U.S. scheduled airlines enjoy in those countries. Moreover, in such circumstances U.S. charter airlines would also likely find that their access to charter opportunities in those countries would be severely jeopardized. However, should we determine that an applicant's homeland is deriving a disproportionate share of the overall aviation benefits, we would be inclined to withhold valuable Fifth Freedom charter privileges from that country's airlines.

We also consider the extent of the applicant's reliance on Fifth Freedom operations (as opposed to U.S.-homeland traffic). It has long been U.S. aviation policy to require foreign airlines to place substantial reliance on their U.S.-homeland operations, with Fifth Freedom operations taking a secondary, supportive role. To this end, we closely monitor the levels of Third, Fourth, and Fifth Freedom operations conducted by foreign applicants. (That said, we have tolerated a higher level of Fifth Freedom charter operations by Caribbean carriers, since airlines of this region are often small, their homeland-U.S. traffic alone often cannot support them, and they must therefore depend for their survival on the additional revenue Fifth Freedom charter operations in U.S. markets bring them.)

We consider, too, the specific nature of the Fifth Freedom request. Many Fifth Freedom charters are subservice (wet lease) operations for other foreign airlines, enabling these latter airlines to maintain their U.S.-homeland operations (operations that are usually expressly authorized by bilateral aviation agreements). Denying the Fifth Freedom charter application in such circumstances would effectively shut down that other airline's Third and Fourth Freedom operations.

We believe that our policies in the Fifth Freedom charter area have worked well, furthering not only U.S. aviation interests, but the interests of U.S. shippers, travelers, and consumers as well.

Mr. OBERSTAR. You have been most forthcoming, as usual, well prepared, thorough, and patient. We have not exhausted all the subjects of international trade, but I think we have covered a fair amount. You have acquitted yourself well, and I thank you for being with us this morning.

Mr. SHANE. Thank you very much, Mr. Chairman. I've enjoyed it immensely.

[Mr. Shane's prepared statement appears on page 169.]

Mr. OBERSTAR. The subcommittee will take a recess until 2:00 p.m., to allow witnesses to replenish themselves for the afternoon and members to do the same.

The subcommittee stands in recess.

[Whereupon, at 12:37 p.m., the subcommittee recessed, to reconvene at 2:00 p.m., the same day.]

AFTERNOON SESSION—2 P.M.

Mr. OBERSTAR. The subcommittee will resume its sitting for the purpose of taking testimony this afternoon from the National Air Carrier Association and its associated members. Mr. Ed Driscoll, president and CEO of the National Air Carrier Association; Mr. Vance Fort, senior vice president, governmental and international relations, World Airways, and former deputy assistant secretary of Transportation, a man who is no stranger to the witness table before this committee; and Mr. William Langton, president of Southern Air Transport.

Welcome, gentlemen. Thank you for being with us. We appreciate your contribution to these hearings and look forward to your presentation. You may summarize your statement as you wish. If so, by unanimous consent, the statement in full will be included in the record.

TESTIMONY OF EDWARD DRISCOLL, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL AIR CARRIER ASSOCIATION; WILLIAM G. LANGTON, PRESIDENT, SOUTHERN AIR TRANSPORT; AND VANCE FORT, SENIOR VICE PRESIDENT, GOVERNMENTAL AND INTERNATIONAL RELATIONS, WORLD AIRWAYS

Mr. DRISCOLL. Thank you, Mr. Chairman. We are all pleased to be here. We appreciate this opportunity to set forth our views with regard to international aviation matters. I will summarize my testimony because it is rather long and covers quite a few points.

The carriers here with me today, and many of the other NACA carriers not represented here, are engaged in the Desert Shield/Desert Storm activities. They were involved in that from the very inception, expanded their capacity throughout the entire operation, contributing between 50 and 100 percent of their entire fleets in support of that operation. And they did have to cancel commercial operations in order to provide that support to the military. The CRAF program in total, operating in support of the military was a great success. Although there were a lot of lessons learned and a lot of changes that are probably going to have to be incorporated, the military have new studies underway already—one with Rand Corporation and the other with the Logistics Management Institute—to assess how successful it was, what changes are necessary.

But the one thing that is clearly established is that notwithstanding all of the cargo capacity that was made available, all of the cargo capacity that we attempted to get from other NATO or SEATO nations, which was very limited in contribution—and we even tried to hire some foreign carriers to operate in conjunction with the U.S. carriers; only one foreign airline did and then refused to operate into the Gulf, would only operate to Europe—all of the U.S. carriers operated in the Gulf without hesitation. But the point it clearly demonstrated is there is a shortage of cargo capacity to serve the Nation in time of emergency when you consider the organic fleet of the military coupled with the entire civil cargo capacity of our Nation. Therefore, that says we have to in some way expand the cargo base of the United States carriers so that they are in better shape, that they can provide more capability to the military in the event of other situations.

You will recall, Mr. Chairman, that you were instrumental I believe, from the investigations and oversight subcommittee, in getting a study underway at the Department of Transportation. That study has been made; it shows that the U.S. base about 36 percent of the world-wide cargo traffic. But, unfortunately, in our view at least, that study has not been fully implemented and the necessary actions have not been taken to expand the cargo capacity. It would be far less expensive to the taxpayer if we expand the civil capacity rather than buy additional organic equipment for the military, because that is extremely expensive. Therefore, we need additional opportunities in order to expand. You can't just buy cargo aircraft without a market in which to operate them. From that standpoint, I think Desert Storm has taught us we do need additional cargo capacity.

From the bilateral standpoint, we need to negotiate more cargo opportunities. We might even have to update the study that was performed to show which markets we really have to go at. One of the markets is, again, the EC. We have suggested to DOT that one of the fundamental things that has to be done is to get the entire industry together—the old cargo carriers, the combination carriers, the fast freight carriers, and the charter carriers all operating in the cargo arena—and come up with a strategy of what it is you have to negotiate vis-a-vis EC and vis-a-vis other countries. From a strategy standpoint, if you don't have a program that you are going to negotiate going in, you never know where you are going to end up.

Likewise, that philosophy applies in the bilateral process to the passenger side. And in our view, under the bilateral what we are approaching here is the case law approach, where each and every bilateral is being negotiated for itself. It is not being negotiated against a total policy overlay of where we are headed. And the ideal example of that is the U.K., that you discussed this morning, and where for the first time "Seventh Freedom" was negotiated and it was given to the United Kingdom. Our industry was not consulted in advanced as to whether Seventh Freedom made good sense or whether we had any views, pro or con.

The same thing happened with respect to foreign investment in aircraft. We weren't asked as to our views on it before the decision was made to increase it up to 49 percent. Now on the foreign in-

vestment I will be quick to say that we do not have a position in opposition to foreign investment. Our position is that if there is to be foreign investment, we must make sure that the national security and national defense are not compromised. And we do know there was serious concern in the Department of Defense on foreign investment and what it may do to the responsiveness of air carriers. As I pointed out, one foreign carrier that did contract with MAC would not fly into the Gulf; they would only go to Europe. So we don't want to have anything happen that would make the civil carriers any less responsive than they are now to national defense considerations.

I believe in addition to recommending requirements the development of decisions, I think what we need is the strategy session. Now, you will be told by the Department of Transportation and the Department of State that, yes, they get the carriers together for a pre-negotiation conference, it is called. And one can state its view, one can send a letter; but once they have it, you don't know what has happened. There is no exchange between the industry and Government as to what really should be done. What we're suggesting here is strategy sessions as opposed to pre-negotiation sessions.

The other international issues are the non-availability of Title XIII insurance. Title XIII insurance was made available for the Department of Defense operations. In addition, the Department of Defense provided indemnity and they not only indemnified the carriers to the extent that Title XIII wouldn't cover, they indemnified the Department of Transportation for any losses that might be incurred. No losses were incurred. Premium Title XIII insurance was not readily available. And any time a carrier applied, it had to go through a maze of agencies in order to see whether or not it would be accorded. Those included: FAA, Department of Transportation, Department of State, sometimes Department of Defense, and last but not least, OMB. And in many cases OMB took the position that even though it was a U.S. carrier transporting war materials to the Gulf under a private contract as opposed to a Defense contract for Kuwaiti forces, Title XIII was not made available even though we were moving ammunition.

Likewise, we had a flag carrier, Tower Air, operating between the United States and Tel Aviv. That carrier was given Title XIII only to bring people back to the United States from Israel because those were evacuations, but Tower was not permitted to operate under Title XIII from the United States to Tel Aviv, even though its competitor El Al, subsidized and given indemnity by its Government was able to operate. And Tower was the only U.S. flag carrier that still tried to operate in that market during the emergency. We believe that not only Title XIII should be made available on an automatic basis when commercial insurance is not available or it is not available at reasonable rates, but when FAA determines the Title XIII rate, it should take the rate that was in existence prior to the happening of the emergency. We so recommend in our testimony here today.

Let us get into the foreign investment in U.S. airlines. As I said before, we do not have a position against it, but we do believe that it must be weighed against national defense considerations and it must be weighed—as in your bill, Mr. Clinger—that we do have an

open regime between the two countries; that we don't get into one of these where we allow the foreign investment when it has restricted entry, because that just gives the foreign source greater power to control U.S. operations.

With respect to the operation of non-certificated aircraft, the C-130, Mr. Chairman, we want to thank you for your direction to Mr. Shane this morning to try to bring that whole group before your subcommittee here to address that which we consider to be outside of the Federal Aviation Act. These operations that get into commercial-type and commercial operations with non-certificated airplanes that are not maintained, they are surplus military airplanes probably going back to the vintage of 1950, and we seriously hope that you will be able through the agencies to work out some system to get control of these. They are being exported illegally into Angola, some were exported into Panama, some are operating for firefighting purposes but immediately divert and go into the Persian Gulf for commercial operations. These operations impact on the commercial operators that are in that business, that are licensed operators, and it deters against their ability to expand their cargo operations which are ones committed to the CRAF program. The C-130s are not involved in the CRAF program. They are not involved in anything except firefighting and then into quasi-illegal operations as far as we have seen.

Cabotage. We don't think you can just treat cabotage as a single subject; you have to look at the interrelationship of code sharing, joint ventures, foreign investment, because it all goes to the bottom line. And this is the reason that we feel, we need to examine the Canadian case. They are advancing some thoughts of cabotage. Before you say no to it, you should analyze it and determine what the benefits and the detriments are, and after you have made the analysis as to whether it is or isn't good, then make the decision whether it is bad or good and then the Congress still has to look at it because the law does preclude cabotage except in the unusual cases as authorized in the Act. So all we are saying is to keep an open mind, look at it, but if it doesn't make economic sense from the standpoint of the United States carriers, it shouldn't be authorized.

The National Aviation Noise Policy. We're pleased that the Congress has come out with this. DOT is in the process of implementing it and we only hope that as a result of that implementation we will, in fact, end up with a National Noise Policy that can be developed between now and the year 2003 as set forth in the Act. I think the industry will support it as long as the rules and regulations governing the phase-out of Stage 2 aircraft take into consideration the Stage 3 aircraft a carrier already has in its possession so that the phase-out is consistent among all carriers and not just as has been proposed—a rigid rule that everybody has to phase-out a percentage of Stage 2 without considering the Stage 3 they have already brought into their fleets.

In summary, Mr. Chairman, we recommend that the Government agencies involved with the distribution and/or regulation of non-certificated aircraft be directed to develop a plan for control of these airplanes and to submit it to your committee for review. You

have already implemented that one this morning by directing Mr. Shane in that regard.

Government agencies responsible for international negotiations be directed to provide the forum and means for initial consensus development through strategy meetings, as opposed to pre-negotiation meetings, with the industry for the development of a negotiating framework for cargo, passenger, and charter services so that a policy will be in place, based upon industry input as well as national security requirements, prior to conducting international negotiations. Such is essential to eliminate the Case Law approach through which agreements are negotiated without full consideration of the impact on industry or national security.

Third, the Department of Transportation be directed to give priority consideration to applications by small carriers for scheduled service and to aggressively pursue the development of expanded charter opportunities, both cargo and passengers, for U.S. carriers. In that regard, Mr. Chairman, we are also pleased that you asked the Department of Transportation to look into the Fifth Freedom charter operations. DOT granted some last week and there is an application over there for four today. Immediately after your suggestion to Jeff Shane that he get into this, we called those four to his attention and he said he would look into them.

Fourth, we urge the Congress to consider the changes we have recommended for Title XIII premium insurance to assure immediate availability in time of need by U.S. air carriers.

That concludes my statement. I will be followed by Mr. Bill Langton, who will further address the C-130s; and Mr. Fort, who will get into the international negotiations.

Mr. OBERSTAR. Mr. Langton, welcome and please proceed.

Mr. LANGTON. Thank you, Mr. Chairman, and members of the committee. The Southern Air Transport appreciates the opportunity to put forth its views with regard to international aviation matters. As a member airline of the National Air Carriers Association, we fully support the positions expressed earlier today by Mr. Driscoll and can add little to most of his comments. There is, however, one particular area of great concern to us, and that is the issue of military aircraft entering the private sector.

Although the remarks I will make for the most part are directed at these military C-130 aircraft, they will be equally relevant to other military aircraft, such as the C-141, C-5, and so forth if these aircraft are to be retired from active military service.

Until recently virtually no C-130 aircraft were in non-military hands. Over the past two years, and most recently in the past twelve months, a disturbing trend has begun to manifest itself. Over 30 old C-130 aircraft—and I am referring to the 1950 vintage aircraft which have been in mothballs for years—have suddenly been popping up in private hands. What is most distressing is that the supposed safeguards to prevent this are either being ignored or, more seriously, deliberately circumvented.

I can provide specific details upon request, but I can tell you of the following recent occurrences. One or possibly two C-130s are currently operating in Angola, flying military supplies for the Angolan Government. Another aircraft has apparently been illegally exported to Panama and its current whereabouts is unknown.

Illegal use of Department of Agriculture Forest Service aircraft is also troubling. Over the past two years, several surplus C-130 aircraft have been provided at no cost to some private companies for the specific purpose of fighting forest fires. We think this is an excellent program and is very cost-effective. However, the paramount condition of this free transfer is that the new owner is prohibited from using the aircraft for anything other than forest firefighting in the U.S. These aircraft are supposed to be physically in the United States at all times to protect our national forest and rangelands from devastating fires. Yet, I can tell you that several of these aircraft are now flying in the Mideast in flagrant violation of the terms upon which the new owners got the free aircraft. The U.S. Department of Agriculture appears unable to take the necessary action to enforce its own regulations which clearly state that if the aircraft are used for anything other than firefighting legal action will be taken.

Mr. Chairman, Southern Air Transport operates a fleet of L-100 Hercules aircraft. Although this aircraft is very similar to the C-130, there is one important difference. The United States Federal Aviation Administration has issued a civil type certificate to the L-100. As the possessor of a civil type certificate, individual L-100 aircraft are then eligible for a Standard Airworthiness Certificate, which in essence is the FAA seal of approval designating the aircraft as safe and approved for civil use. The C-130 has never been issued a U.S. standard type certificate. Our L-100s played a vital role in logistic support for Desert Shield and Desert Storm, both within the United States as well as overseas.

Desert Storm has reinforced the critical need to have a strong and viable airline industry in the United States which can be called upon in times of national need. Mr. Chairman, we are not seeking an unfair competitive advantage; we can compete with the best as long as the game is played on a level playing field. I've heard that term many times this morning, but it is a very true statement.

Regrettably, Mr. Chairman, despite assurances from many agencies that concrete steps will be taken, these aircraft continue to leave the country and find their way into commercial aviation. Individual U.S. Government agencies have been cooperative, in particular, the FAA. However, the problem will persist because no one agency appears to have total oversight of the many aspects of this issue. The FAA, for instance, can police activity in U.S. air space but has no say overseas. The Department of Defense disposes of aircraft but has no means of policing what happens when the aircraft enter the private sector. The Department of State issues export licenses despite the prohibition against use in commercial aviation. U.S. Customs cannot stop an aircraft from leaving the U.S. and cannot get it back once it does.

We would like to recommend that one Federal agency be designated as the absolute clearinghouse for the disposition and use of C-130s and other military aircraft that may find their way into the private sector. Additionally, specific regulations should be issued that must include a requirement to clearly mark all such aircraft and associated documents, including certificates, transfer documents, export licenses, et cetera, with the pertinent restrictions.

Lastly, enforcement must be initiated against those individuals and organizations who either permit aircraft to enter into illegal operations or who actually conduct illegal operations, and the penalties must have some teeth in them.

Mr. Chairman, thank you again for allowing us to present our thoughts.

Mr. OBERSTAR. Thank you very much. We appreciated your testimony, Mr. Langton.

Mr. OBERSTAR. And now, Mr. Fort.

Mr. FORT. Mr. Chairman and members of the committee, I am Vance Fort, senior vice president, governmental and international relations for World Airways. I appreciate very much the opportunity to testify here before you today concerning the international aviation policy of the Administration. The committee's focus on the bilateral agreement reached last week between the United States and the United Kingdom concerning the transferability of Heathrow landing rights is particularly timely and important. I, too, have prepared a lengthy statement for the record, and I will summarize it at this time.

It is troubling in the extreme to witness the Administration hand over valuable and unprecedented economic opportunities to British carriers simply in exchange for the continued right to an American flag presence at Heathrow. We do not begrudge United, American, TWA, and Pan American the benefits bestowed upon them by this recent agreement. Nor do we oppose the liberalization of the international service rights of foreign carriers to serve the United States. We are, however, concerned about the apparent willingness of the Administration to take care of the big U.S. airlines seemingly at any cost, and to do so without even a semblance of a long-range pro-competitive international aviation policy; a policy consistent with the whole of the Declaration of Policy spelled out in the Federal Aviation Act, section 102.

Indeed, it would appear that the Administration has fixated on subparagraph (4) of the Declaration of Policy which speaks to the "placement of maximum reliance on competitive market forces." The fixation on that section is used to justify almost any scheme devised by large carriers to obtain new route authority, to buy and sell existing authority, to buy and sell slots and gates and airport access generally, and to trade assets and equity between them to meet their strategic considerations without regard to the public interest.

Gone, it seems, is the vision and the emphasis of past Administrations on subparagraphs (9) through (12) of the Declaration of Policy; namely, to encourage actual and potential competition, efficiency, innovation, and low prices; to encourage entry into markets by new carriers, to promote, encourage, and develop civil aeronautics as a viable and privately owned United States air transport industry; and to strengthen the competitive position of the United States air carriers to at least assure equality with foreign air carriers. Gone, also, Mr. Chairman, is the feeling throughout the aviation community that the unpredictable could happen; that the Departments of State and of Transportation were on the side of the little guy or on the side of competition, and would flex their considerable muscle in pursuit of opening up markets and, again, level-

ling the playing field for all participants. Today a kind of cynicism pervades the city and the industry.

Today it seems we accept the failure of deregulation to remove barriers to entry; to produce a growing number of innovative, low-cost, low-priced, service-oriented carriers; and to spread inexorably around the globe. Today the passion is not competition, but globalization; not small but big; not innovation but strength; not bilateral confrontation but accommodation; and certainly not the consumer but rather the market.

Mr. Chairman, the picture is not as black and white as just painted, but it is our overwhelming perception of the Administration's policy, and this policy has left smaller carriers like World, and those represented here, anxious to see the pendulum swing back.

Of course these are rough times for everyone in the aviation industry, large and small carriers alike. Publicly, the Administration has taken the position that the airlines will have to weather the current crisis without governmental assistance. However, despite this rhetoric, the Government is doing much to help certain carriers stay afloat, primarily by allowing the sale of routes and slots. In an indirect way, a government bailout of the industry is in progress with the sale of these public rights—route authority and airport access—substituting for direct financial assistance.

This aid is tantamount to a selective subsidy. It benefits only those members of the scheduled airline community whose operations previously allowed them to obtain these scarce and valuable public rights. These rights have never been evenly distributed, and they are becoming even less so as weaker members of the scheduled carrier industry conduct their own private carrier selection cases in proceedings to sell these rights off in order to keep flying. Moreover, and more troubling, is that under present practice, scheduled carriers continue to enjoy a favorable claim on the distribution of these public benefits.

There are a number of areas where the interests of the small and nonscheduled carriers have had questionable support. Let me just very quickly outline them.

International Route Proceedings. Recent allocations of international route authority reveal a persistent bias in favor of larger carriers to the point where smaller carriers have become alienated from the process.

This is a far cry from the early days of deregulation when international routes were routinely awarded to innovative small new entrants like World. It is ironic that DOT considers smaller carriers "too risky" to be awarded significant international route authority when many other carriers who have received such awards are the very carriers who today are selling those awards to the highest bidder.

Giveaways. The present Administration has entered into agreements like the Heathrow Airport deal that are so loaded with benefits for foreign carriers that there will be frankly nothing left to trade in future negotiations. Somewhere along the line, our negotiators lost sight of the fact that no deal is preferable to a bad deal.

The Administration has also given away important bargaining leverage by allowing foreign carriers to serve "underserved" Amer-

ican communities on an extra bilateral basis without securing commensurate benefits for U.S. carriers in those foreign countries. No other country unilaterally grants such extra bilateral rights of this scope to U.S. carriers.

Charters. Too often charter rights are left out of the bilateral negotiation process or are scheduled for discussions at an unspecified date in the future. The unwillingness of U.S. negotiators to press their foreign counterparts on charter matters is a glaring failure of aviation policy which places non-scheduled operators at a severe competitive disadvantage. It is interesting that even as we speak negotiations are going on with Greece in Washington today. We have sought desperately to have our Government reach a charter accord with the Greeks. I will be very interested to see if, yet again, an agreement is reached that doesn't include charter rights.

Fifth Freedom operations by foreign carriers, Mr. Chairman, has been mentioned already here. Let me say simply that World has since December had a formal request pending at the Department of Transportation for a Declaration, for a statement by the Department of its policy in this regard. We have been rewarded thus far with total silence. I, too, support your request of Jeff Shane respecting some clarification of the Department's policy in this regard.

Finally, Mr. Chairman, let me simply say, that World does welcome the recent decision by Secretary Skinner to relax the restrictions on foreign investment of U.S. carriers. It seems to us that opening up new sources of private investment, albeit foreign, is preferable to unfairly permitting a few privileged U.S. carriers to profit from the sale of their common carrier rights. It is certainly preferable to stagnation and bankruptcy in our industry.

We'll be happy to answer any questions. Thank you.

Mr. OBERSTAR. Okay, thank you.

You've raised some very important issues of basic policy in aviation trade that we wanted to pursue and to some extent have done with Mr. Shane earlier.

Let me come back to Mr. Driscoll. You spoke about CRAF and the role that it played in the Gulf War airlift. What about the compensation that carriers receive in providing services under CRAF? First, how is compensation reached? I'm not talking about the payment on CRAF, but the actual contract for carriage?

Mr. DRISCOLL. The contract carriage is a peacetime contract with expansion into emergency. The rates that are effective in peacetime are the rates that are paid during a stage one or a stage two call up. The only time that you would be able to negotiate a different rate is if a stage three called up. Stage three was not called up this time.

So basically, the carriers operated at a mile—or so much per ton mile, so much per passenger mile, rates that were in effect at peacetime.

Now, there were some additional charges outside of that that are still being discussed and negotiated. I don't know those are going to come out, because when you go into an emergency type operation, you operate differently than you do in peacetime between a pair of points; therefore, additional costs were incurred. Those are still under consideration by the military.

Mr. OBERSTAR. Was the increased cost of fuel calculated separately?

Mr. DRISCOLL. The fuel was a pass through, sir. So that's always been in the contracts as a pass through. Therefore, if the rate of fuel goes up, it's adequately taken care of under the contract.

Mr. OBERSTAR. Supposing we didn't have a CRAF program and the Defense Department had no more airlift capacity than it actually has today for this type of activity. What would have been the cost to the military? They would have had to contract—

Mr. DRISCOLL. I will have to go back in history, sir. Prior to having the CRAF program—and this goes back into the 1950s prior to the implementation of the back role in peace and war, which was the fundamental document that got this new system in effect—we didn't have a program that could be called up. And anytime you got into an emergency, it was usually 10 to 15 times the price you paid in peace, because the price you paid in peace—because you were a big purchaser, there were no minimum rates at that time established by the CAB, it was all competitive—and you drove the price down to the point that it bankrupted the carriers. But then, come an emergency, the price escalated 10 to 15 times.

This is one of the major benefits of this CRAF program. That it does take and ensure the military of a quantified amount of lift available in various stages with uniformity of price and guarantees of aircraft with four crews per airplane to ensure that you can operate at 10 hours a day.

One of the points under the program, Mr. Chairman, that is also going to have to be addressed is when you call up an aircraft and the carrier cancels contracts—commercial contracts make those airplanes available—then, of course, one would expect that the carrier be compensated for those airplanes that were made available. Unfortunately, that was not the case.

They called more airlift than they needed. For days, the carrier had to stand by waiting to perform and got no compensation for it at all.

Mr. OBERSTAR. And meanwhile the aircraft so "called up" were out of revenue service?

Mr. DRISCOLL. Yes, sir. Then they said, "Okay, go back and put them into revenue service. If we need them again we'll call you."

Mr. OBERSTAR. But you've lost that money, and there was no way to reclaim those losses?

Mr. DRISCOLL. That's right. Then you try to put them back into revenue service, it's very difficult on short notice even when you're subject to call, because stage one and stage two have not been deactivated. They're still in effect inactive.

Mr. OBERSTAR. If you had not had the formal activation, under your CRAF agreements, would carriers have been able to move civilian traffic?

Mr. DRISCOLL. If the carriers had not been called up under stage one, yes, they would have continued to operate the commercial traffic unless the war, as it did, caused a lot of cancellation.

Really, I think the military delayed, possibly—and this is Driscoll's opinion, not shared by many, I guess, but some—that really the call up of stage two was delayed because of the tremendous pressure on the civilian economy during the Christmas holiday

season and they delayed it into January before they called a stage two.

But, basically, the carriers would have been operating in their commercial markets except for having been called up under stage one, except for those that volunteered the lift.

Bill, wants to say something.

Mr. LANGTON. Well, I think it's important that when stage one was called, all of stage one was called. That included passenger and cargo. The requirement was really for passenger movement.

So that was why we got into the problem with cargo airplanes showing up to the air base with nothing to move. They sat there for days on end with no reimbursement. That's really what created the bottleneck.

I think as part of some studies that are going on now, procedural changes will occur, so that it can be a little bit more selective as to calling up what's required rather than the "whole enchilada."

Because of that, when cargo lift got so critical, they were afraid to call up stage two. It was peak season. Passenger carriers would get dragged into it when, in fact, they made a decision to call it stage two, but to apply it to cargo carriers only.

Mr. OBERSTAR. Has your association calculated the losses to its number of carriers for that idle time when they were called up and not operating?

Mr. DRISCOLL. We have not calculated that except each individual carrier has probably calculated that himself.

Mr. OBERSTAR. I can well appreciate that the carriers might not want to complain too very loudly to the Defense Department, saying, "You called us up and then we sat there, nothing happened", but this is not quite the same as the old hurry up and wait with the Army. We know that all too well. I can appreciate your delicate position.

But I'm asking the question, because I think this is a serious competitive matter. While your carriers, that is your association member carriers, had aircraft either on the ground, waiting, or in the air operating, they're out of revenue service. Other competitors, foreign nationals, were flying their routes. They were exercising their rights.

Now, maybe in the overall scheme of things that didn't amount to a billion dollars, but a million here and a million there, to paraphrase former Senator Everett Dirksen, it adds up to real money.

Mr. DRISCOLL. Yes, it does. The military, as I say, are trying to take a look at some of these claims that have been filed for this loss revenue, sir. That is going to be the matter of further discussions. They're also going to take a look at amendment of the CRAF program as to what should be the policy in the future.

They have the two studies, the Rand Corporation and the Logistics Management Institute, doing two independent studies for them; one for Defense, and one for Air Force. I think the thing in the long-term will get handled.

Insofar as the claims are concerned, each individual carrier is a contractor with the Government. Each individual carrier would have to file its claim directly. There's no way that the Association could take and file a claim on behalf of its carriers. It's an independent contract between each carrier and the U.S. Government.

Mr. OBERSTAR. Well, I'm aware of the studies and I think that when they're completed, this committee will want to have a review of the CRAF program. We will undertake that review. In fact, Mr. Clinger and I were talking about doing such a review several years ago when we were working in the Investigations and Oversight Subcommittee. I think that's a matter that needs to be pursued further.

The Chair at this time will yield to the gentlewoman from Missouri.

Ms. HORN. Thank you, Mr. Chairman.

I won't continue the questioning. I do thank the gentlemen, especially Mr. Ford. I think that was a very fine statement that you had and also the other gentlemen. Thank you for being here today.

Mr. OBERSTAR. Let me pursue the matter of Tower Airlines, which was of some concern to us and which we communicated during the early stages of the Gulf stages. The Department of State and the Office of Management and Budget together concluded that the policy of the United States should be to get U.S. citizens out of the war zone and not to in any way facilitate or encourage the introduction of more U.S. citizens into the war zone or into the region.

Therefore, they were not willing to provide liability insurance for carriage of passengers from the U.S. into the Middle East, though, interestingly, in order to get the aircraft there, they were willing to provide haul insurance, U.S. to Middle East, and let the carriers try to find in the private market liability insurance, which as you and I discussed, was at prohibitive rates.

Mr. DRISCOLL. It wasn't available at the time, too at any rate.

Mr. OBERSTAR. Not only rate prohibitive, but in most cases, not even being offered.

The point is that competitive carriers with foreign national airlines were providing that service. So by a sort of half-hearted policy, "We'll get your aircraft into the Middle East so we can carry U.S. passengers out," meanwhile failing to understand that carriage of passengers into the region was, in effect, subsidizing or providing a financial base for the return portion carrying those passengers out. The OMB didn't tarry long enough on that subject to really understand it.

Having gone through this exercise—I just recreate the circumstances in gross, so that on the record, we have the background—what lessons are there to be learned about this war risk insurance policy? God forbid we have any more conflicts. But things will happen, and the policy ought to be foresighted enough to envision these matters. What lessons are there to be learned for the future?

Mr. DRISCOLL. I think lesson number one, sir, is that if you're going to have an effective low risk insurance program, that insurance has to be made available immediately and not by a committee approach of several different agencies all getting in; one voting yes, another voting no. It should be, rather, an automatic type of insurance.

Item two, as far as the operations or let us say some of our partners or coalition members of the war effort, if you have to move ammunition for the Kuwaitis or ammunition for the Saudis, and

that's part of the coalition force, they certainly should have given us the insurance on that.

They were so short-sighted in some cases to force us to use commercial insurance for cargo. You could get commercial insurance at exorbitant rates for the cargo. They weren't passengers. Only to turn around and find that the shipper had a Government reimbursement-type contract.

So we moved them for the shipper. We've got commercial insurance. Commercial insurance was charged against the shipper. The shipper turned around and charged it against the United States Government who in the first instance wouldn't give Title XIII coverage.

So it's the Government shooting itself in the foot, sir.

Mr. OBERSTAR. Well, that's one of the lessons I said that we should learn from that experience. We will revisit the CRAF program and Title XIII insurance at another time. I mean very certainly to do that.

As a part of that inquiry, I think you're suggesting that Title XIII insurance should be available automatically. If so, I think the objection on the other side, the Government side, the Administration side, is that would expose the U.S. Government to an open ended cost. What limits, then, could be imposed or how would the limits be established?

Mr. DRISCOLL. When we say it should be made available automatically, sir, whenever it's in the interest of the United States to move or to maintain one of its carriers in operation between a pair of points.

Let us take New York, Tel Aviv. If the Administration has not said, there will be no operations between New York and Tel Aviv and your operation specs are marked so that you can't operate, that's one thing, then we couldn't get Title XIII. But as long as your operating specs haven't been marked that you can't operate, but you're permitted to operate, you're permitted to move passengers and Americans are free to travel on your competitor just by going down the street and buying a ticket, then I think the limitations on its availability should be—unless the United States Government has cancelled flying operations between a pair of points—that insurance should be available as long as it serves in the National interest.

Now, the National interest is a question that can be easily decided by DOT. You don't have to take and then get into OMB. Is it cost effective? Is it too much of their exposure to take on, because decisions were made on exposure not on whether it was in the economic interest of the United State? They said, "it's too great an exposure to take on." That was the exact position of OMB.

Mr. OBERSTAR. It certainly was, and it was a decision driven by considerations other than our foreign policy interests.

Mr. DRISCOLL. Right.

Mr. OBERSTAR. On the one hand, they wanted to have U.S. carriers in the region to carry U.S. nationals and goods out of the region. On the other hand, they weren't willing to offer the incentive necessary to get the U.S. carriers. So they were, in fact, losing market share to our competitors who were perfectly willing to fly

the service and whose governments were not only willing, but, in fact, able to and were providing the necessary insurance.

Mr. DRISCOLL. I wanted to say, Mr. Chairman, that Steve Gelband, a director at Tower in their Washington counsel, had hoped to be here today. He was delayed in New York and couldn't get down. He has a statement that has been submitted. We only ask that his be incorporated into the record, because it does deal with some of that on the Title XIII.

Mr. OBERSTAR. Without objection that statement will be included in the record.

Also, a question for Mr. Gelband about how when they were flying that service they were using foreign nationals as flight attendants, which certainly raised some questions—I'll let him respond to that question in writing.

[The response to Mr. Oberstar's letter follows:]

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March 22, 1991

James L. Oberstar, Chairman
 Subcommittee on Aviation
 Committee on Public Works and Transportation
 House of Representatives
 Room 2165, Rayburn Office Building
 Washington, DC 20515

Dear Congressman Oberstar:

This is in response to your letter to Ed Driscoll, President of the National Air Carrier Association, dated March 20, 1991, concerning the use of foreign national flight attendants by Tower Air, Inc. I am general counsel of Tower Air.

First, let me say that I am sorry that I was unable to attend your committee's hearing Tuesday. I had, as you know, intended to testify on behalf of Tower Air about the necessity for our government to provide policy nourishment to small, innovative, low-cost, post-deregulation scheduled carriers like Tower Air, or there will be none left to provide competition to the mega-carriers. I was, however, called to New York at the last minute to negotiate the purchase of two additional B-747 aircraft for Tower Air's fleet.

Tower Air, as my written testimony shows, is the only still-existing U.S.-flag post-deregulation scheduled international carrier. It has been able to compete with the mega-carriers by establishing a few "niches" where its low-cost, low-fare operations have the maximum effect. Our problem is that the regulators in the Department of Transportation who control bilateral negotiations have been unwilling to negotiate authority for Tower Air to expand into the additional "niche" markets of Greece, Italy, Spain and the U.K. in which Tower Air is interested. Any help that you and your committee can give us on this subject would be very much appreciated.

HEWES, MORELLA, GELBAND & LAMBERTON, P. C.

Congressman James L. Oberstar

March 22, 1991

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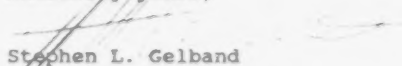
With regard to the specific questions raised in your letter, three of the very large number of charter flights that Tower Air operated for MAC during Desert Shield and Desert Storm were operated with foreign national flight attendant employees of Tower Air on board. As a general rule, Tower Air does not utilize its foreign national cabin crewmembers on MAC charter flights unless it has no alternative crewmembers available, which was the case regarding the particular flights in question. The company has no specific present plans to utilize foreign national cabin crewmembers on future MAC flights to the Persian Gulf area, but will do so if it again becomes necessary.

The specific MAC charter flights to the Persian Gulf on which foreign national cabin crewmembers were utilized were operated on December 4, 12 and 26, 1990. A fourth flight from the States to Brussels also operated with such cabin crewmembers. A few cabin crewmembers on the listed MAC charters operated to Saudi Arabia were Tower Air regular employees who were citizens of Scandinavian countries -- countries which supported the coalition's efforts. The majority of the cabin crewmembers on each such flight were U.S. citizens.

The issue of whether Tower Air is permitted to utilize foreign national cabin crewmembers on MAC charters was thoroughly investigated by the company and, as you can see from the attached letter from the Department of Air Force, was deemed to be permitted in accordance with government policy. All Tower Air flight attendants, including those that are foreign citizens, are fully trained by the company and meet all the requirements of its FAA, Part 121, certificate. The Air Force does not deem it necessary for special security precautions to be taken on MAC flights utilizing foreign national cabin crewmembers.

I trust that the above provides the information which you requested. Please let me know if there are any further questions.

Sincerely yours,


Stephen L. Gelband

Attachment

cc: Mr. Edward J. Driscoll
President/CEO, National Air
Carrier Association

SENT BY: Xerox Telecopier 7020 : 3-21-91 : 10:25AM :

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DEPARTMENT OF THE AIR FORCE

MILITARY AIRLIFT COMBAT OPERATIONS STAFF

SCOTT AIR FORCE BASE, ILLINOIS 62228

21 December 1990

Tower Air, Inc.
ATTN: Mr Jim Capraro
Hanger 8
JFK Intl Airport
Jamaica NY 11430

Dear Mr Capraro

The Civil Reserve Air Fleet (CRAF) contract provides that a CRAF carrier provide four complete crews for each aircraft volunteered to the program. It further requires that the cockpit crewmembers must be US citizens and cannot have any other military commitment (i.e., no Reserve or National Guard commitment). There is no similar restriction on flight attendants. They may be foreign citizens so long as they are trained and certified as Tower Air flight attendants and meet all the requirements of your FAA, Part 121, certificate.

Ronald W. Priddy
RONALD W. PRIDDY, Col, USAF
Chief, Readiness, Civil Air
& Operability Plans Division
Directorate of Operations Plans
DCS/Plans & Programs

Mr. OBERSTAR. The point that you also raise, that is of great concern to me, is that there is at least one carrier that refused to fly into the theater of action. Now, if you match that experience with the other policy being formulated or evolved here in the department of expanded foreign investment in U.S. carriers, eventually I can see the situation develop with air carriage that exists with our sea lift capability, or more precisely, lack thereof.

I also serve on the Merchant Marine and Fisheries Committee. We held extensive hearings on this subject of sea lift capability. At the end of World War II, the United States had 16 million tons of shipping capacity. We were number one in the world with more than 2,500 surface vessels.

Today, we are number eight. That's dead last. We have fewer vessels than the Polish National Fleet, which is second in the world. Fewer than almost anyone else in the world. We don't have a single, commercial, sea-going freighter being built in a U.S. shipyard today. Not a one.

Of 19 shipyards in the United States that existed 15 years ago, only one is not in bankruptcy. Most have ceased to exist. The Navy doesn't have the sea lift capability. You know what they did? They said, we're going to use our War Risk Insurance program with foreign built vessels, and we will be able to call on those ships in times of national emergency.

During the ten years of the Vietnam War, not a single foreign vessel was called in by the U.S. Navy to provide sea lift capability, even though it was needed.

Again, in this situation just recently with the Gulf, the Navy was wringing its hands in the Defense Department over the lack of sea lift capability.

If we continue this policy to its ultimate logical conclusion of unrestricted foreign investment in U.S. carriers and ownership, we may find ourselves a day when we need that airlift capability and the carriers say, "Sorry, fellows, we'll carry them to someplace safe, but not to where you need them."

Mr. DRISCOLL. Right.

Mr. OBERSTAR. The Chair yields to the gentleman from Ohio.

Mr. HOBSON. Just two comments, Mr. Chairman, or questions.

One, I share your concern about the 130s, and I hope we can look at that at some point about how those 130s get out and how we can get some control over them when they're gone.

The question I have is to come back to this foreign question, Mr. Driscoll, that you alluded to before or talked about. Were there other foreign airlines that were asked to commit capacity that refused to submit capacity to us?

Mr. DRISCOLL. Let me see if I can understand you correctly, sir. It's my understanding that the U.S. Department of State, at the request of the military, did go out to all of the NATO countries asking them to volunteer capacity for the United States' operation and the coalition's operation in the Gulf.

Korean Airlines did volunteer some capability. Kuwaiti Airlines, the airplanes they were able to get out, they made theirs available. The Japanese did not have aircraft they could make available, so they made a substantial financial contribution and said, "We'll provide and pay for the transportation to the Gulf."

Those three countries, Japan, Korea, Kuwait, are the only ones I know that volunteered any lift.

Beyond that, the military then went to the foreign countries and said, "We'll pay for the lift at back rates the same as we're paying the U.S. carriers, if you will make your equipment available."

It's my understanding only two carriers volunteered. One, a Canadian carrier, that I don't believe was ever checked out. They were going to fly passengers. The other one was a Dutch carrier, but the Dutch carrier making it available said, "No, we'll only operate between the States and Europe. We will not operate into the Gulf."

The military, probably, can give you a better scenario than I can on that.

Mr. HOBSON. Well, along with the sea lift problem that we have, we could face, depending on how all this breaks out, I think, a very serious problem in the future if we have to revisit this type of situation in the future. Obviously, there's no reliability on others from what you're saying, and I assume it's correct, as to the capability of moving this type of cargo in a fast basis. I guess it also says something about those who will stand up with us at a time when you need to stand up.

That bothers me, as we look at the foreign investment. Even if it's 49 percent and you've got directors on your board that are saying, "If you want the next 10 million dollars invested in this company, I'm not so sure we ought to do that," or however it goes. In any interest of the world, if we're going to carry on this type of activity, it gives me some pause. I share your concern and the Chairman's concern about this.

Mr. DRISCOLL. There's another link to this, if I could, sir.

We operate in peacetime as charter companies mainly in the cargo area, World, Southern, Evergreen, we're all dependent upon the traffic that we can pick up. We're not asking for a competitive edge, all we're asking for is equal treatment. Yet when our Government takes and authorizes foreign carriers to fly freedom operations out of the United States repeatedly, that's taking revenue out of the very airlines that supported our Government in a time of emergency.

I think that's another item that has to be addressed. The Chairman this morning asked Jeff Shane to get into this freedom operation, because today there's far more trips by a Canadian carrier, that, under our basic rules and regulations, shouldn't qualify for this freedom, but is allowed to take traffic from New York to Saudi Arabia when a U.S. carrier is very able to perform that.

There's nothing in our bilateral or anything else that would authorize that because we cannot, U.S. carriers, carry anything out of Canada, because they exercise a right of first refusal.

This is something, Mr. Chairman, that has to be addressed during these Canadian negotiations. Are we going to have a decent charter accord with Canada?

Mr. HOBSON. That's all I have, Mr. Chairman, thank you.

That's very enlightening testimony.

Mr. OBERSTAR. To follow up on the point that the gentleman from Ohio, Mr. Hobson, made, Mr. Langton, I just want to be clear about your position.

You have no problem with the transfer of those C-130 aircraft for the public purposes for which they were intended; for fire fighting use or other public service use by State or Federal entities, such as U.S. Forest Service or Park Service for forest fire fighting.

But your concern is that policy is not being enforced and that lack of enforcement has allowed these aircraft, then, to come into commercial competition with yourself and others.

Do you have any ideas about why there is no enforcement? Is it simply lack of information; the State Department not informed about it? How could such a series of things have occurred that the aircraft were transferred to a State agency that allowed them to be used by a private entity which then goes into commercial operation. The FAA approves, because the State Department says, this is an emergency, we need this aircraft.

There's a whole series of steps to collapse of a system. It should not have happened. Is it lack of information or lack of effective oversight mechanisms? What do you think went wrong?

Mr. LANGTON. I think simply that it started off as it's not a major event, to all those that are to be overseeing this. It's not important enough to dedicate a whole lot of time to. That's how it starts out.

The second thing is there are so many different agencies involved in how it can occur, that they either rely on the checks and balances that should occur, but do not occur. I just simply think it's one of those things had we not raised it—and we're raising it not only for this current instance, but because it poses a potential serious problem into the future. We might as well nip it in the bud right now.

If the system is incapable of controlling it, then let's stop right here and either control it or don't release X military aircraft for these purposes.

We go through massive investigations to see if Qadaffi gets any C-130s. Well, in the meantime out the back door the C-130s are going out on a daily basis. It makes no sense.

Mr. OBERSTAR. Your concern is that there are some 2,400 of those produced and a lot of them available for service, and they don't meet FAA standards, they weren't certificated for a carriage of the cargo that they're actually handling?

Mr. LANGTON. In this particular instance, you're talking about an airplane that did come out of Davis-Monthan. It has been parked for many, many years. The Air Force said to the Forestry Service, "Here, you can have the airplanes for these purposes."

So they actually will take parts off of one and try and rebuild an airplane that is functional. But it's with the concept that we're going to be flying out of some bush airport over uninhabited areas fighting forest fires.

We don't need to have a 121 environment around an airplane of that nature. But as soon as it slips out and starts landing on major airports and going across our major cities, then it seems to me that's the time to stop and say, let's put those controls around the type of aircraft so that we do have a very airworthy aircraft that's in our air spaces. That has not occurred.

We have a very explosive problem that can occur. It ought to be cut before it ever gets to that point.

Mr. HOBSON. I think the 130s are supposed to be replaced; aren't they?

Mr. LANGTON. Well they're retired.

Mr. DRISCOLL. There's 15 new ones coming in this year as I understand it, which will require some more from the Air Force. So there's probably about 140 additional airplanes under the Department of Defense that's going to be available over a span of years for sale.

Mr. HOBSON. And that's part of your problem. You're worrying about what's going to happen to those if they fall in the same kind of pattern and there's no control; correct?

Mr. DRISCOLL. Right.

Mr. LANGTON. Right. And, of course, these are the least attractive of all the models over the nearly 30 years now of production of C-130s. The later ones are really a very nice airplane and would be—many of our foreign militaries that are not really on our side would love to have those aircraft.

If these are the least attractive, and they're slipping out. Without the mechanism pretty soon, the very attractive ones will start slipping out.

We have cases right now, foreign militaries are offering for sale, some of the later versions that we sold them. So the controls are not there. Nobody is singly overlooking the whole procedure. There's something inherently wrong with that; plus we have 141s.

Mr. HOBSON. Do you think there will be a problem with 141s?

Mr. LANGTON. I wouldn't think so. But "A" models, I didn't think, would be a problem either.

Mr. HOBSON. Thank you, Mr. Chairman.

Mr. OBERSTAR. The gentleman from North Carolina, Mr. Ballenger.

Mr. BALLENGER. Thank you, Mr. Chairman.

I wasn't here for the hearing, so I'll just pass.

Mr. OBERSTAR. The gentleman from Tennessee, Mr. Duncan.

Mr. DUNCAN. I have no questions, Mr. Chairman. Thank you.

Mr. OBERSTAR. All I can say is we sure could use some of those 130s in Northern Minnesota when we had those forest fires in the Superior National Forest and the Chippewa National Forest. We've got the old twin engine Otters up there and Beavers scooping water out of the lakes and trying to bomb those fires. They made more trips than these 130s do in a month.

Mr. DRISCOLL. I'm sure if you contact the Forest Service, they'd be glad to make some of their's available.

Mr. OBERSTAR. Well, now I know where to find them. You got some of these carriers that are out there in the Middle East.

Mr. DRISCOLL. The guy's name you want to talk to is Fox. He's over there. They, in good faith—he told me personally, he did not know and authorize those airplanes to go to Saudi Arabia that went over in violation of the agreement he has with the operator to come over.

Mr. OBERSTAR. They ought to be Exhibit 1 for aging aircraft legislation.

Thank you very much, gentlemen. We appreciate your testimony. We will, as I said, follow up on the cabotage issue and the negotiations with Cantor, we'll continue to follow that one very closely

and monitor those negotiations. We will pursue the matter of strategy meetings with DOT prior to your negotiations and follow up on this latter issue of the C-130s.

Mr. DRISCOLL. Thank you, sir. It was a pleasure to be here.

Mr. LANGTON. Thank you.

[Mr. Driscoll's prepared statement appears on page 114.]

[Mr. Fort's prepared statement appears on page 139.]

[Mr. Langton's prepared statement appears on page 150.]

Mr. OBERSTAR. Our next witness is the president of the Air Line Pilots Association, Captain Randy Babbitt.

Captain, welcome to our hearings. Thank you for your patience through a rather long day.

Mr. BABBITT. Thank you, Mr. Chairman.

Mr. OBERSTAR. We look forward to your testimony.

TESTIMONY OF RANDOLPH BABBITT, PRESIDENT, AIR LINE PILOTS ASSOCIATION, ACCOMPANIED BY RUSSELL BAILEY, ATTORNEY

Mr. BABBITT. Thank you very much, sir. As you know, I am Randolph Babbitt. I'm President of the Air Line Pilots Association and with me today is Russell Bailey, an attorney with our Association.

I'm here representing 43,000 pilots from over 44 airlines. I appreciate this opportunity to appear before the subcommittee today to present ALPA's news on international aviation policy and the bilateral agreements.

I'm also testifying today in my capacity as the Vice President of the Transportation Trades Department of the AFL-CIO, which is composed of 25 affiliated unions representing millions of workers.

The topics on your agenda today are of a critical importance not only to our Nation's pilots, but to an entire industry. ALPA believes that globalization—the international expansions of U.S. carriers and their integration with carriers of other countries—will be the most important issue facing our air transport industry in this decade.

We've already seen a major impact on our industry by international operations. In the last half of the 1980s, the revenue from international operations of U.S. airlines grew by nearly 15 percent a year, more than double the rate of growth from domestic operations. Maintaining that growth will be important now that our domestic market has matured, particularly because international operations contribute disproportionately to the bottom line.

For example, in 1989, United Airlines derived only one-fifth of its revenue, but over one-third of its operating profits, from its Pacific operations. At Northwest Airlines the comparable figures were one-third and two-thirds.

The current scramble for international routes being sold by TWA and Pan American shows just how vital U.S. carriers consider international growth. Unfortunately, the sales of those routes reduce the chances for viability of our primary international airlines, Pan Am and Trans World.

How can we meet the challenges posed by globalization and successfully compete on a world-wide scale? ALPA believes that we must establish clear goals and make decisions based upon those

goals. We want the United States air transportation system to serve and benefit the traveling public by meeting four goals. Number one, being safe, financially sound and independent. The second, being capable of competing in the global market. Third, being capable of maintaining and increasing quality jobs for our citizens, and, finally, being capable of recapitalizing itself with U.S. funds.

As we begin to address the issues of globalization, let's keep in mind the lessons we've learned from our past mistakes. The 1980s were extremely painful for U.S. airline employees. Almost all major airline pilots working today have suffered through disruptions caused by mergers, and a significant portion of those pilots have had at least one carrier go bankrupt.

We can't help but believe that these mergers and bankruptcies were the consequences of a hasty and poorly implemented deregulation. Few, if any of us, have seen any real improvements to our air transportation system that have been real and lasting.

So we're alarmed by those who call for rapid international deregulation. Let's not repeat on an international scale the mistakes we've made on a national scale.

I'm not saying that ALPA is opposed to change, especially constructive change. Not at all. But as we look at the opportunities to increase our flying opportunities abroad, we must keep the financial health of our air carriers clearly in sight.

I would like to address some of the key international issues from the view of the Nation's pilots. But first I would like to take this opportunity, Mr. Chairman, to thank you and the other members of the committee for your leadership in opposing the inclusion of aviation services in GATT.

We believe that the introduction of H. Con. Res. 280 and the subsequent cosponsorship by over 180 members of the House sent a strong message to our trade negotiators. We only hope that they continue to heed your advice.

One of the key international issues is what our policy should be with respect to foreign investment in U.S. air carriers. The Federal Aviation Act restricts foreign ownership of voting stock in U.S. airlines to 25 percent, limits the number of board seats and corporate positions foreign citizens can hold and has been interpreted by the CAB and the DOT to prohibit foreign citizens from actually controlling U.S. airlines.

The Act is not designed to prevent airlines from obtaining access to foreign capital markets, and ALPA fully recognizes that some of our airlines could well benefit from injections of foreign capital.

We do question, however, whether foreign investment is going to be a miracle cure for financially ailing carriers. We believe there are several reasons why foreign control has been, and should continue to be, prohibited.

First, as the Gulf War has illustrated, our country has a very real need to protect our national security interest. A large portion of the military goods and personnel transported to the Gulf was carried by commercial airlines voluntarily provided by U.S. airlines under the Civil Reserve Air Fleet agreement (CRAF). Foreign ownership raises important questions about the continued availability of CRAF service.

Second, transportation is a vital sector of the U.S. economy, comprising almost 18 percent of our GNP. This industry is an integral part of the transportation system. If foreign control were permitted, valuable assets and resources could be diverted from U.S. to foreign airlines, potentially crippling our industry.

Third, the U.S. market is the largest aviation market in the free world, and U.S. carriers have a distinct competitive advantage over their foreign counterparts in many areas. Given that over the past decade the United States has dropped from being the world's largest creditor nation to being the world's largest debtor nation, do we really want to risk having another of American industry's crown jewels come under foreign control?

Because we are concerned with the dangers of foreign control of our airlines, we are troubled by the DOT's recent hasty decision allowing KLM to invest up to 49 percent of the equity in Northwest Airlines. Surely, the DOT must realize that if a foreign investor pours hundreds of millions of dollars into an airline, he's going to want to exercise some control to protect his investment.

An even more troubling aspect of the DOT's decision to raise the limit on KLM's permitted equity investment is that it removed the administrative oversight that could have ensured that the equity investment would never be used to control Northwest Airlines.

A second key issue is what our policy should be with respect to the transfer of international routes. We believe that the transfer of international routes can, in certain circumstances, benefit the carriers involved in the transfer. We are concerned, however, about route sales that have adverse effects on the carriers involved and their employees.

For example, look at the recent sale of TWA's London routes. These, certainly, are TWA's most valuable routes. In its own submissions to the DOT, the airline referred to them as "the key to their future." ALPA believes that this sale will lead to an acceleration of the carrier's financial losses and its speedy demise, especially because TWA has presented absolutely no plan as to how it will use end proceeds of the route sale to revitalize the carrier.

Unfortunately, the DOT has tentatively approved the sale of three of the routes without the protection ALPA had requested for the employees. So even more airline employees face threats to their careers.

A third issue raised by globalization is whether we should permit foreign carriers to engage in cabotage operations. To cabotage, we answer, no way. The result of granting cabotage rights would be foreign airlines entering our largest and most attractive routes, most of which already have extensive service by U.S. airlines. In a stagnant, domestic industry with many mature markets, this "cream skimming" would have the net effect of taking passengers off of U.S. airlines and putting them on foreign airlines.

Our industry has averaged only a two percent return on equity over the last ten years. We are in simply no condition to compete with foreign airlines, particularly since most of them receive government financing.

In addition, Article VII of the Chicago Convention—to which the U.S. is a signatory—prohibits the granting of cabotage on an exclusive basis. Thus, if the U.S. grants cabotage rights to one country,

it would set a precedent to be observed in all future bilateral negotiations.

Now, if you ask our Government negotiators about this precedent, they would tell you that if cabotage is given to one country, other countries can ask for it, but the U.S. does not have to give it to them.

ALPA has had enough experience with pattern bargaining to assure you that such a strategy will not work. The U.S. cannot give cabotage to one country without all other countries making cabotage a deal breaker in future bilateral negotiations.

There is one variation on the cabotage proposition that has recently been advanced that I would like to address specifically, the suggestion that perhaps U.S. crews fly foreign aircraft in U.S. domestic markets. Unfortunately, this does nothing to address the principle problem of cabotage—again, the diversion of U.S. domestic traffic and revenue away from U.S. carriers.

A fourth key international issue, and one that has specifically been designated as a topic of today's hearing, is the soundness of the bilateral negotiation process.

ALPA believes that the bilateral approach to negotiating aviation agreements has been successful. U.S. carriers have gradually obtained more and more flying opportunities as the aviation regimes governing international flying have become increasingly liberalized.

Congress has appropriately established as the primary goal of our international aviation policy "The strengthening of the competitive position of the United States air carriers to assure at least equality with foreign air carriers, including attainment of opportunities for United States air carriers to maintain and increase their profitability."

We believe that with this goal as the polestar, our negotiators should be able to achieve additional opportunities for U.S. carriers to expand their international services. But as the recently unbalanced agreement with the United Kingdom demonstrates, there is no substitute for caution and close analysis when negotiating an agreement. If the U.S. had not limited access to Heathrow to just Pan Am and TWA in 1980, there would have been no need to ransom ourselves in 1991.

Finally, we believe that one very important fact affects many of the international issues. The fact that most foreign airlines are owned in whole or part, or assisted by their governments. We simply cannot adopt an aviation policy that would pit our privately owned carriers in head-to-head competition with foreign carriers that received government subsidies or other benefits that our carriers do not.

I know you're aware of the recent direct subsidies to several European carriers by their owner-governments and actions by the European Community to alleviate the effects of the Gulf War. How did our Government react? By letting the free market forces push airlines into bankruptcy or to its brink. This is the fundamental difference in philosophy that makes international competition so tough for our U.S. carriers.

Based on the information presented, ALPA has several suggestions for Congressional action.

First, Congress should continue to send a clear message to the administration that it will not accept the GATT agreement that includes aviation services.

Second, Congress should amend the Federal Aviation Act so that significant foreign investment in U.S. carriers will be subject to prior review and approval by the DOT to ensure that a foreign entity will never have actual control over American carriers.

Third, Congress should amend section 401(h) of the Act to prohibit route sales that undermine the financial viability of an airline. Congress should require that route sales be conditioned also on the transfer of the number of employees required to actually operate the routes being transferred.

Fourth, the Department of Transportation should establish a more enlightened and human policy with regard to the treatment of employees in connection with route transactions. In cases like Pan Am and TWA, the carriers should be encouraged to find buyers who would acquire the whole carrier, including employees, rather than selling off their routes piecemeal.

Alternately, if the routes are purchased separately, the acquiring carrier should be required to take an appropriate number of employees as part of the deal. We believe it is unconscionable that the valuable assets of a failing carrier are allowed to be "cherry-picked" for the benefit of a strong carrier while the employees and their careers are left high and dry.

Furthermore, under the current policy, the Federal Government is often left holding the bag in the form of huge, unfunded pension liabilities, enormous tax revenue losses and unemployment compensation when thousands of workers lose their jobs.

Mr. Chairman, I thank you and your committee members for giving me the opportunity to express deep concerns of our Nation's airline pilots. The issues discussed today affect our very livelihoods and we urge you to consider them with the future of our air transportation system in mind.

This completes my prepared testimony. I would be glad to answer any questions that you or any of the committee members would have.

Mr. OBERSTAR. Thank you very much, Captain Babbitt. You, as always, made a very comprehensive statement and a very reasoned analysis of the issues before us and offered some policy considerations for the committee as we pursue this matter both in this hearing and for the future.

With respect to the cabotage issue, I think your concern is as an organization more than the potential loss of cockpit and cabin crew jobs. It's really a concern about the loss of revenue passengers for the carrier?

Mr. BABBITT. Yes, sir.

Mr. OBERSTAR. While there may be schemes that could protect the jobs of your members and those of your associated unions, the flight attendants or machinists—more properly, flight attendants—but it's the loss of revenue passengers for the carrier and the carrier's potential loss of revenue that is of the greatest concern, following that, of course, the viability of the carrier.

Isn't there a kind of creeping cabotage happening de facto in the marketplace with this recent Northwest Airlines-KLM arrangement under which they're going to share an aircraft?

Mr. BABBITT. I believe that the Department of Transportation needs to keep particular attention on that. That could be viewed as a vehicle to get around bilateral negotiations, quite bluntly.

Mr. OBERSTAR. Mr. Shane said, "Well, this isn't new. It's happened before. There is a precedent, a similar arrangement with another carrier." He said, of course, this is an arrangement between two consenting adults. I just wonder who is going to be the loser in that arrangement?

Mr. BABBITT. It doesn't necessarily guarantee its morality even if it is consenting.

I guess what bothers us is the concern that we continue to find ways to fringe the edge of what we're trying to protect as the goal.

If we go all the way back to the premiss of what we did in 1978, for a second. We had a very good national transportation system. We said, we think—we, collectively, the Congress and the people of the United States—thought that it could, perhaps be made better by removing some of deregulation. Now, we've seen that it may be necessary to regulate some pieces of it in order to protect and ensure that our own transportation system is capable of doing the pieces that I laid out.

For example, being able to recapitalize itself, being able to employ U.S. citizens, being able to participate in a grand scale. In the CRAF operation, as we recently saw, if we allow the infrastructure to be used, our infrastructure, our airports, our ATC system, when comparing with Europeans when we talk quid pro quo, they come over and fly into the most sophisticated airports in the world. They fly with the most sophisticated map systems made available to them in the world, free. All of this provided by U.S. citizens, U.S. tax payers money.

If they were driving on roads that we paved, we would charge them users fees. But yet we allow them to go through our skies. It just concerns us that our own basic system is being raided to some extent.

Mr. OBERSTAR. I raised that point in the testimony with Mr. Shane that as a long range concern and a broad policy concern I have is that the European Economic Community is still fumbling around. Two years ago when I participated in discussions in Belgium with the leadership of the EC, I talked with the airport operators, the European Community in Munich, I said then, you have an antiquated system. Europe has one-fourth of the airspace as compared to the United States and twice as many air traffic control centers. You hand aircraft off by telephone, not by computer.

A Spanish controller won't accept French aircraft in its airspace without a phone call from the French air traffic controller. That's ancient. You need to modernize your system. It doesn't work. You have all these problems of military airspace reservations. Aircraft can't fly efficiently. There are 5 million hours of delay in Europe with, again, one-fourth the airspace as the United States, annually—I meant 100 million hours. We had a 114 million hours of delay in the United States in 1990, over 100 million hours of delay in Europe. It's fewer airports and less airspace.

How are we going to take full advantage of economic opportunities when they're operating with an antiquated system? Well, we're sort of preaching to each other, but the point has to be made that when we negotiate rights, we have got to also negotiate values. It has to be value for value and right for right. I'm not convinced that we're getting full value for our negotiations.

At this point let me yield to the gentleman from North Carolina, Mr. Ballenger.

Mr. BALLENGER. Thank you, Mr. Chairman.

Mr. Babbitt, I can understand the problem that you can foresee. It doesn't take a great deal of thought on anybody's part. I was just sitting here wondering—having seen the various changes or efforts to change that have been made in—shall we say wages, pilot wages, I don't even really know how competitive American is with United. It seems to me there's some variation there.

But if Northwest cut a deal with KLM and KLM's wages were substantially less than Northwest, it would make a little bit of sense to me that they might be trying to make a little extra money by cabotage.

I'm just curious as to how competitive various wages of the operations pilot, copilot, stewardesses and so forth, how do they stack up us compared to Europe?

Mr. BABBITT. Actually, they're fairly competitive when you throw in a lot of the subsidies that their governments provide and their retirement plans and health plans and so forth. They have a distinct advantage. They can devote, in other words, more dollars directly to the payroll and less to medical type plans, because they are government provided.

Also, I think it's worthy of noting, on large aircraft the percentage of the crew cost is a very small portion. I think we're looking at a bigger piece. We all accept, and have accepted, I think, pretty wholesomely that this is a consumer driven economy. But, I think, you need to look a little beyond just the consumer and realize in the United States who the consumer is. The consumer, in almost all cases, is also an employee; that is, if you don't have any income, then you have nothing to buy anything to consume with.

So if we focus solely on protecting the rights of the consumer in bilateral negotiations, we may well in the short term produce a wonderful benefit for a number of consumers for a short period of time. However, eventually, a lot of people are no longer going to be employees, therefore, ultimately won't be consumers in the long run.

So I think we need to balance that. You've seen some observations made by our bilateral negotiators that the other carriers tend to worry more about their carriers and their country's interest. We seem to be focused more on the consumers.

Well, that's very wholesome. But I think you need to balance the interest of the consumer in the short term, I emphasize the short term, to what that consumer will get in the long term. Because if we allow an unbalanced process that constantly benefits the consumer—and remember the benefits the consumers enjoyed in the early first blush of deregulation—in the long run, we're now seeing a consolidation of three major carriers that have geographical mo-

nopolies and are capable of exercising a tremendous amount of market dominance.

We're concerned enough that it's happening domestically. We certainly wouldn't want to create a scenario that would allow it to happen internationally.

Mr. BALLENGER. I just saw advertisements in the newspapers this morning. I could fly from New York to London and back twice for what I was charged to fly from here to Raleigh, North Carolina and back. Monopolies do exist. Anybody that lives where I do and flies out of the Charlotte airport, recognizes you can't find any planes down there except U.S. Air.

It appears to me that here we have this price war going and everybody's losing money. As a businessman, it seems like the dumbest thing I've ever heard of to go around and cut each other's throat. If the pie is small and you reduce the size of the pie, you're going to get a smaller piece, no matter if you get a little bit more. I don't know, somewhere around the line it just doesn't make any sense.

Mr. Chairman, I've always read stories about the Postal supplement that we give the airlines. Is it any value at all? Is the amount of money that our Federal Government gives to the operations of the airlines of any value?

In the good old days, when Eddie Rickenbacker would get in his two-seater and fly the mail back and forth, the Federal Government gave some assistance. I just wondered, do we underwrite any of the use of the airlines any more with Federal aid?

Mr. OBERSTAR. If the gentleman yields. There is no direct Federal aid, but the value of the Postal Service contracts collectively for the passenger carriers, totaled up to about a billion dollars a year until just recently when, for security purposes, the mail was taken off the passenger carriers and put partially on cargo.

There is a very substantial Government activity that provided a source of cash flow and revenue, a billion dollars a year for the carriers. Then you have the CRAF program which amounts to a few hundred million dollars a year. They do benefit from the research and development that the U.S. military has invested in developing advanced design technology. But that's nothing compared to the European investment in Airbus and the direct subsidies.

The direct subsidies that the European Common Market countries provided for their carriers just recently when the Gulf War depressed economic activity and those carriers were facing severe economic losses. We don't do anything near what the Europeans do for their side.

Mr. BALLENGER. Like I say, I'm not real knowledgeable along those lines.

Mr. BABBITT. It would be my understanding that the amount of money that is paid to transport the mail is commercially competitive. In other words, if anyone were to ship 300 million pounds, they would pay approximately that same amount. It's a competitive rate for the amount of weight hauled.

Mr. BALLENGER. It's really not any kind of a supplement?

Mr. BABBITT. No, sir.

Mr. BALLENGER. It's providing a service.

Mr. BABBITT. Someone who was going to hire that space out in the luggage compartment, it happens to be the U.S. Government.

Mr. BALLENGER. I don't have any other questions, Mr. Chairman.

Mr. OBERSTAR. The Chair recognizes the gentlewoman from Missouri, Ms. Horn.

Ms. HORN. Thank you, Mr. Chairman.

Captain, you alluded to the fact that TWA has presented no plan as to how it will use the proceeds of the route sale. And that ALPA believes that the sale will lead to the acceleration of the carriers loses and speedy demise. Could you spell that out a little bit in general the consequences to domestic service by losing an international like that?

Mr. BABBITT. In simple terms, the way we have explained it before, an airline operation is a very complicated mechanism of bringing fees in, and in some cases internally subsidizing its operations; making more money on some routes than it does on others. Those routes are at the heart of TWA's structure across the Atlantic. To take those routes out of that structure would be analogous to taking a part out of your transmission and hoping that it would still run.

Once that part is out, we're not as sure as it will run anymore. Some little pieces you could take out and throw away. But that one is a major, major portion that drives the TWA system from all financial analysis that we've seen. So to take that much out of that system, that major component out of that machinery, if you would, may not allow it to function. So clearly they have to reinvest somewhere else that will create the same kind of synergies to that system.

Right now they may, in fact, have such a plan. We think that they should, in fact, make it clear before they sell that route. Remember that route was given to them in the initial instance based upon a hearing where they demonstrated public convenience and service and so forth based on their carriers operation.

It was granted in that interest. Now, that we're going to allow them to sell it, I think it's incumbent upon the Department of Transportation to see that the public interest continue to be served by them reinvesting that money in some other portion of it. Do they plan to fly other routes, increase service? There's some very wholesome things they could be doing. We're just suggesting that they ought to explain what that is.

Ms. HORN. You haven't mentioned frequent flyer programs. That would have a large impact losing those sales; wouldn't it also? Doesn't that prove to be so in terms of the attractiveness of being in a certain airline's frequent flyer program?

Mr. BABBITT. I guess it is. I'll defer that that's probably more of a marketing question. I do hear it raised that certain destinations would inspire you to accrue miles on one airline so that you could exercise your frequent use to another. But that's more of a marketing question.

Ms. HORN. On another topic, with the recent approval of the Pan Am sale to United and then TWA to American, what ability do the pilots have and the employees have who have seniority and are flying those routes? Is that taken into consideration at all in DOT?

Is there any kinds of discussions ongoing at management level, at the employee level?

Mr. BABBITT. Well, unfortunately in the past, it would have been. Under the Civil Aeronautics Board it would have been most likely compelled that a certain number of employees would have been identified and moved over with the routes.

Since deregulation, however, and the sunset of the Civil Aeronautics Board, there have been no route transfers that took employees with them with the exception of those where the management made it part of an operation to avoid a furlough exposure. In some cases you're obligated to pay furlough pay, if you would.

A good example would be when Pan American sold their Pacific operation to United Airlines years ago. They specified the number of employees that would go with the operation. It was a ready-made packaged deal. They were integrated.

Unfortunately, today, we're not seeing that as part of the transactions. It's manifested itself. What we're seeing at Pan Am is now announced furloughs. There will be a number of employees who will lose their jobs, because the routes that they flew, that work is no longer available. So the carrier will take the money and they will lose their jobs.

Obviously, the acquiring carrier will have the need, if they intend to fly new routes, they'll have to hire some pilots. But they're under no obligation to hire those that got furloughed, which is difficult, because many of these senior people are well along in their careers.

It's obviously more difficult to compete even though there's EEOC rules. It's difficult to compete as a 55 or 56 year old airline pilot in the hiring line with a 25 year old who has good qualifications. It's just a very unfair contrast.

Also, I'm not even mentioning the fact that he has lost the accrued seniority and things that go with that seniority when he is removed from that route.

We do have some internal policies. They're not enforceable except among ourselves. I say internal to the Air Line Pilots Association. Management is under no obligation to accept them. They don't sign our policies, and therefore, aren't obliged to accept them.

We do have a good situation with the United Pan Am transfer. We did transfer a small number of pilots over. That's because we were able to work things out internally and with both managements. We're not going to be so fortunate, I don't believe, with TWA and American.

Ms. HORN. I find that very distressing, but other than some serious unfixing of what we thought we would fix with deregulation, I suppose that can't be addressed. When United was willing to do that they were in a better financial situation. It was just something they saw. When Pan Am and United were able to do that with the Pacific routes, it was because of a stronger financial situation they were in or what motivated them to do it then and they're not talking about it anymore?

Mr. BABBITT. Well, in terms of collective bargaining, if you would, two things could drive that. One, the selling carrier not wanting to be exposed to furloughing the people and having the ex-

posure of furlough pay and so forth, could demand, as a condition of sale, that X number of employees must go with the deal.

Conversely, the buying carrier wanting to have an instant operation, not wanting to go through the training and so forth, the Pacific operation would be a good example. The very pilots that flew those routes—that were familiar with those stations, that were familiar with the operation, that trained on that equipment—they went right over; instant, turn key.

So the acquiring carrier might want to have that.

Ms. HORN. But you see no signs of that in these two most recent——

Mr. BABBITT. This particular operation, no. There are no signs. There have been no offers. The handful of pilots that did go over in the Pan Am United, it was because of ALPA policies and internal negotiations that brought that about. We've been flatly turned down with any employees in the TWA to American transfer.

Ms. HORN. Thank you for that information. No more questions, Mr. Chairman.

Mr. OBERSTAR. The gentleman from Tennessee, Mr. Duncan.

Mr. DUNCAN. Captain Babbitt, thank you for your testimony. Let me say that I agree with you in your opposition to foreign ownership of U.S. airlines. I wish we didn't have any of it.

In your testimony you say, at one point, the Act is not designed to prevent airlines from obtaining access to foreign capital markets and ALPA fully recognizes that some of our airlines could benefit from injections of foreign capital. Like I said, I certainly don't disagree with you, but how do we get those injections of foreign capital if we say that they can't have more ownership interest of something?

Mr. BABBITT. Well, I'm presuming that in some of the cases that they don't have any and that there is a level—we're concerned with at what level? Do we compare debt inequity? If I sold you 49 percent of the company in stock, that's okay. If you had 49 percent of the debt, does that enter into the equation?

Some of these are vagaries at this point. We think that the criteria should be more clear. We think that prior to these transactions occurring that there be some review to see what limits we are going to. Those are our primary concerns.

I guess go all the way back. One of the concerns—and I believe I've addressed it earlier in testimony with this committee—and that is what concerns us deeply is the fact that we have to turn to foreign capital to get anybody to invest in the carriers in the first place.

What is wrong with our carriers that people in the United States won't invest in them? Are they such poor investments that no one wants to put money in? The answer I seem to be hearing is yes. They've only produced two percent in the last ten years of return on equity. Why anybody would want to invest in them is beyond me. You would do much better anywhere in town with a CD.

So I think, again, the premise that we took all the regulations off and have burdened them with so much competition, absent any regulation, they seem to be weighing themselves down with unrestricted competition.

Mr. DUNCAN. Now, you say we've burdened them with so much competition, but I've heard you testify before and I think you and I also agree that we would be better off if we had more airlines in this country. You favor that; don't you?

Mr. BABBITT. Yes, sir.

Mr. DUNCAN. I'm a little confused when you say we've burdened them with so much competition. Are you talking about allowing the foreign competition in primarily?

Mr. BABBITT. That would be an additional burden, yes, sir. That's one of the concerns.

Mr. DUNCAN. But really what you would like to see in the ideal world is more competition, but with a larger number of airlines?

Mr. BABBITT. We think that there's a variety of ways that you can have the competition that is wholesome for the consumers and at the same time, allow our carriers to recapitalize themselves, get a return on their investment.

That's really at the crux of why we can't attract domestic capital, is there's so little return. The airlines are not very profitable.

Mr. DUNCAN. Let me ask you this, there's another portion of your testimony that I also agree with but I also have a question about you said on page 11, "Congress should amend S. 401(h) of the Act to prohibit route sales that undermine the financial viability of an airline." I don't think there's anybody here today who would disagree with that statement.

But that's not really the question, is it? If TWA or Pan Am was to come to you and you are the Secretary of Transportation and they said, "we think we can survive, but we've got to downsize and we've got to sell some of these foreign routes so we can survive." What do you do then?

Mr. BABBITT. What we have set forth is going through the steps of reviewing, and in this case, you have laid out one that we would be agreeable to. They have set forth a plan that was sensible.

Mr. DUNCAN. In other words, even though you don't like it and I don't like it—the sales of these foreign routes—you would agree that it would need to be done if it meant the survival of the airline?

Mr. BABBITT. Yes, sir. There have been other cases where the protests that were made that selling these routes will ultimately be tear the carrier apart—a case comes to mind. It was not a foreign, but we watched a carrier piecemeal itself off to the point it had lost any ability to operate.

Mr. DUNCAN. Let me ask you this on another thing. On page nine you say, "If the U.S. had not limited access to Heathrow to Pan American and TWA in 1980, there would have been no need to ransom ourselves in 1991." I'm like Mr. Ballenger, I'm not an expert on this. What happened then? What did they do?

Mr. BABBITT. Typically, in bilateral negotiations, the two countries agree that one, two, three carriers can compete and they name the gateways. It's very unusual that you actually name the carrier. In those particular negotiations in 1980, they specified TWA and Pan Am.

So later on in 1991 when both of those carriers tried to sell routes, the U.K. said, well, you can't just change them. Remember, they're limited to those two corporate names.

So in order to change the corporate paint job, really, it was necessary to go back into the bilateral negotiations, and we were over a barrel. I don't think it was any mystery or surprise to the U.K. that the Department of Transportation needed to effect those transfers for the well being of the carriers involved. At least that was the position presented to the Secretary by both of those carriers that they needed to complete those transactions.

Mr. DUNCAN. I know you don't like deregulation. I think really, though, it's not all black or white. There are some parts of deregulation that may have been good and there are some parts that may have been bad. Hopefully you would agree with me on that. Would that not be an example of Government overregulation or regulation that was harmful to these two airlines? In other words, the Government interfered and the U.S. limited this access through this agreement?

Mr. BABBITT. I think it was an error in the negotiations, really, back in 1980. I think that if they could have foreseen that someday they might want to transfer those two airlines corporately—those routes would be sold—it gave the other side a tremendous lever to extract some things that ordinarily they wouldn't have.

Mr. DUNCAN. It was a mistake that the Government made in the negotiations?

Mr. BABBITT. Yes, I would accept that.

Mr. DUNCAN. Pan Am and TWA would not have made that same mistake?

Mr. BABBITT. Ironically, I would imagine that they probably thought it was a pretty good idea in 1980. I think they might change their tune in 1991.

Mr. DUNCAN. This isn't really the subject of this, and I'll just mention this. We've covered it before. Don't you think that one of the best things we could do would be for the Department of Transportation in every way possible to do everything they could to ease the entry into the airline market for some new, smaller companies?

Mr. BABBITT. I've suggested before that one of the problems in keeping competition up—and I do agree with you, there have been some good things that came from deregulation, unfortunately, we went too quickly. Rather than going very metered and seeing how things went, all of a sudden we found ourselves with this tremendous market force centered in three carriers or four carriers that have the ability to stifle a new entrant.

I don't think that's wholesome. I think at some point we're going to have to step back and say fortress hubs are not wholesome to the consumer. We're going to have to find ways to permit new entrants, because right now on a sheer economic basis, there is no way. There just isn't.

Mr. DUNCAN. Thank you very much.

Mr. OBERSTAR. I think the gentleman's line of questioning is very important and very productive.

The bilateral that was negotiated with the U.K. was not a mistake on the part of the U.K. They very carefully negotiated that agreement. They did not want major U.S. carriers entering that market. They negotiated it specifically to have in that market the carriers that were permitted and not to have anything more substantial.

It was very clear that Pan Am did not have a domestic route system. They did want a carrier with a strong domestic route system in the U.S. coming in to that market to compete with their carrier, British Airways. They just, frankly, either out toughed us or out smarted us in that negotiation.

Now, things, of course, are a very different environment.

Mr. Kolter.

Mr. KOLTER. Thank you, Mr. Chairman.

Captain Babbitt, when you were being interrogated by Ms. Horn, I believe you indicated that some of your members had been furloughed. My first question is, how would the introduction of cabotage effect employment levels in the industry?

Mr. BABBITT. If a carrier, for example—I would presume that any carrier who was going to cabotage, would certainly do it on a lucrative route. They would do so—especially where our fear is—on a cost competitive basis. A Government subsidized carrier could come in with very low fares and begin to take business away while our carriers, being private, would abandon a route just as they've done in regulation.

When they went from regulation to deregulation today, when someone wants to come in and dominate a route and throw the economics behind it, eventually, someone is going to say, "That's enough. I quit. I won't fly that route anymore."

When that happens, the block hours flown by that carrier are reduced, and they don't need as many pilots.

Mr. KOLTER. Captain Babbitt and Mr. Chairman, I just returned from making a speech on the Maquiladora Process in Mexico where our business people send parts to Mexico. People are employed there at approximately \$50 a month total without benefits.

In reading your testimony on page three, you're talking about GATT, and page four you talked about foreign ownership, could there be a possibility, Captain Babbitt, of perhaps some group moving to Mexico—a group with a lot of money—eventually buying into some airline and then using this cheap labor to replace pilots, to replace the personnel in planes? Could that be a remote possibility?

Mr. BABBITT. Not under today's laws it's not. But if the laws were changed and Cabotage were permitted, that absolutely could happen. That absolutely could happen.

Mr. KOLTER. So what you're telling us is we'd better be on our toes here?

Mr. BABBITT. Yes, sir. We request that.

Mr. KOLTER. Thank you.

Mr. OBERSTAR. The Department has relaxed its foreign investment restrictions to give the industry an opportunity to attract capital, because the industry is saying, "We're capital starved. We have a cash flow problem." Last week one of the leaders of this industry testified before our committee that the problem is liquidity. That we need to have more investment in order to maintain liquidity.

If the industry is capital starved and its principle investors are likely to be foreign carriers, and further, if those carriers are now in such trouble that their own Governments are working to bail them out, as the EC attempted to do in relaxing some of its restric-

tions just a couple of weeks ago, where is that capital going to come from?

Mr. BABBITT. The foreign capital itself?

Mr. OBERSTAR. Well, any. If the foreign carriers are in such trouble that their Governments have to bail them out, how are they going to have the capital to invest in the U.S.?

Mr. BABBITT. I agree. I recently read an article of world wide concern for capital shortages, which I think will be exacerbated by rebuilding in the Gulf region. But I think if those carriers thought that they had an opportunity to control U.S. carriers by their investments, I think the Governments that were interested in such things would find the capital. That's a matter of concern.

It's an alternative realizing if you had control, you can alter the competitive system. You as a foreign carrier having control of a U.S. carrier, could you and I really expect wholesome competition to go on between those two carriers? I don't think so.

Mr. OBERSTAR. Well, I don't think any reasonable person looking at the situation would believe a foreign investment entity saying, we're going to put money into a U.S. carrier, because it's a good investment, we're going to get a good return on that capital, in an industry that's never made more than a \$1,200,000 collectively in a year; an industry in which the member carriers are dropping like flies.

Why would you put money into an Eastern? Why would you put money into one of the—let's say, TWA with all of the problems it's got, we'll just be frank about it, you might better go dig a whole in the backyard and put \$400,000,000 there. You won't lose the money. You won't get any interest on it, but you won't lose it.

What they're interested in is not return on their investment, but control of the carrier they're investing in so they get entry into the market in the United States and get a piece of the world's largest open free market with the biggest number of people travelling both domestically and internationally of any trading partner in the world. That's what they're interested in, in my judgment.

Mr. BABBITT. I would agree with you, I think, along those lines. I hope it's appreciated that the essence of my testimony is that Congress should take a good hard look at taking the measures that make our U.S. carriers healthy enough to attract U.S. capital. I think that's the long-term goal.

Mr. OBERSTAR. Yes, that's certainly true. Are there any circumstances under which your organization would support foreign investment in financially ailing U.S. carriers or foreign investment in potential new domestic U.S. entrants into competition?

Mr. BABBITT. Really, based on the criteria that we've set forth, I think that criteria should be fairly standard, otherwise, I think we invite the creation of straw operations just to get the control that you and I are so cautiously trying to avoid.

Mr. OBERSTAR. Are there any conditions that ALPA would accept for operating rights or permitting cabotage for foreign carriers in the U.S.?

Mr. BABBITT. There's absolutely no condition that I've seen presented that would do anything wholesome in the long run for the airlines themselves, for the employees of the airlines and for the

consumers of the country in the long run. I see nothing wholesome coming from that in the long run. I emphasize the long run.

In the short term, we only see a brief possibility for the consumer to enjoy, perhaps, a fair reduction over specific high density routes.

If you look what's happened to domestic deregulation, now what we're seeing is a reversal of the old regulated system where the long haul subsidizes short haul. We're seeing just the converse today. It's very inexpensive to fly tremendous distances on highly competitive routes. But unfortunately, as was pointed out earlier, try and get a flight down to a small city in North Carolina. A variety of the small city fares are tremendously expensive with fare increases in the 600, 700, 800 percent range.

So if you happen to live in those small cities, you are paying the price of deregulation so that the chosen in the two large cities on the east and west coast can enjoy a little bit of a fare reduction. It's a terribly unbalanced way to operate our system.

Mr. OBERSTAR. You have contact regularly with your counterparts in other countries. Let's just take, for example, Europe. I'm sure there are pilot associations for each of the national carriers. What are their concerns about these same issues of cross investment both within the European Community, cross investment from the U.S. to Europe, investment from Europe to the U.S., and cabotage within their marketplace?

Mr. BABBITT. Well, most of them realizing that most of the countries in the EC are more comparable to States in our country are of such size, they're so small, that it would probably appear to be attractive to them. They certainly are concerned about the ownership. I think they, in some cases, fear privatization, because they realize what impact that will be on them.

But cabotage to them in this country is viewed as a job opportunity. So we're looking at it through very different lenses, if you would.

Mr. OBERSTAR. Thank you very much. We appreciate your testimony. You've been very, very helpful to us in the pursuit of these matters. Of course, as I said at the outset, this is another in a continuing series of the committee's inquiry and monitoring of international aviation trade and the investment and ownership questions that are auxiliary to it.

Mr. BABBITT. Thank you, sir, and we appreciate your ongoing interest in these matters that are near and dear to us.

[Mr. Babbitt's prepared statement appears on page 99.]

Mr. OBERSTAR. Our next witness is the Allied Pilots Association, Captain Alvah Mattox, the government/industry coordinator.

Captain, welcome. We're glad to have you here. We appreciate your participating in the hearings and for your patience throughout this rather long day.

Mr. MADDOX. Thank you, sir. I would like to introduce my shy friend, Marty Seham. He is an attorney at the Allied Pilots Association.

Mr. OBERSTAR. Please come and join Captain Mattox at the table.

**TESTIMONY OF ALVAH S. MATTOX, JR., GOVERNMENT/INDUSTRY
COORDINATOR, ALLIED PILOTS ASSOCIATION, ACCOMPANIED
BY MARTIN C. SEHAM, ATTORNEY**

Mr. MATTOX. Good afternoon, Mr. Chairman, members of your committee. As you know, I am Captain Alvah Mattox, Jr., and the Government/Industry Coordinator for the Allied Pilots Association.

Our organization is the certified representative of some 8,500 airline pilots in the employ of American Airlines. It is also the representative of pilots flying with certain American Eagle operations.

Of all the issues of discussion that we've heard today, APA finds the subject of cabotage the most troublesome. The Association's position on cabotage has already been presented to this committee in the form of a written submission by Captain Fred Vogel, president of the Association. And I would like to present a brief oral summary of that submission.

Those who advocate cabotage argue that increased foreign competition in our domestic aviation market would benefit the American public. We disagree. We believe foreign airlines would reap the benefit of American taxpayers investment in its infrastructure without offering any lasting benefit in return.

The roads that lead to the airport, security, runways, traffic control are all part of a heavy and ongoing investment made by the American people in the Nation's infrastructure. A foreign manufacturer building a factory in this country will avail itself of the American infrastructure but will contribute in exchange a physical plant and jobs which become an enduring element of our national economy. In contrast, a foreign airline, which carries a passenger from Chicago to San Francisco, makes no contribution and leaves no asset. The American taxpayer is thereby subsidizing a foreign enterprise whose sole function is to syphon off dollars from our economy.

Cabotage advocates insist that increased foreign competition will make American companies more efficient. This argument disregards the fact that most foreign carriers are government owned and subsidized. Making a profit on a particular flight is often subordinated to the foreign government's other goals, such as increasing tourism or maintaining employment levels. When the competition we face comes from foreign airlines which are not profit driven, it can only serve to destroy healthy American companies.

The competition of cabotage will also herald an unprecedented development in the American labor community. A substantial portion of a national industry will be manned by employees who are not covered by American labor law. American aviation employers will have to scramble to compete with the competitive advantage that comes with lawlessness. This is another form of competition which we should be avoiding at all costs.

Finally, the competition of cabotage would cause unfair competition in the area of labor costs. On one end of the scale, American companies would compete against Western European airlines whose employees' medical costs are picked up by their respective governments. On the other end of the scale, American companies would compete against Third World airlines which pay wages which are commensurate with a much lower cost of living in those

countries. In either case, cabotage would necessitate a response to such unfair competition. The result would be severe depression in the standard of living of the American aviation workers.

The jury is still out on whether the additional competition provided by deregulation ultimately worked to the benefit of the American people. Before deregulation is applied on an international scale, we have to take a look at the potential costs and benefits. For the reasons I have discussed, the Allied Pilots Association believes that the initiation of cabotage is not in the national interest at this time.

Thank you very much. I will be pleased to answer any questions.

Mr. OBERSTAR. Thank you, Captain. The complete statement of Captain Vogel will appear in the record. It is replete with important issues that are addressed in a very thoughtful way. We want that to be a part of this record.

One of the concerns throughout this hearing has been globalization of the air transport industry. To some extent, that is already happening. There is a great deal of cross-investment both among certain European carriers, led principally by SAS which has invested in a number of other carriers, but Swissair as well is investing in others, British Air has attempted a considerable broadening of its investment scheme, and now we have KLM investing in Northwest Airlines. It is underway. It is happening. The question is, is it good for the air transport industry. We have heard about the U.S. automobile manufacturers who are including parts manufactured in many foreign countries in their automobiles marketed in a domestic marketplace; not so much because they wanted a world car, but because they are looking for ways to reduce the cost of components and to reduce the cost of their product to keep it competitive with the imports.

The question really is, are there some benefits and what are the downsides of that globalization.

Mr. MATTOX. Well, our Association has not really developed an official policy on foreign ownership of U.S. airlines. However, I would like to take you back in history not too awfully long ago and maybe relate to you a story of an exchange that the pilots of American Airlines had with our own company, and it really boils down the matter of if we go back to initial pay rate issues—A scale versus B scale. Our employer came to us and said, we have X amount of dollars to invest. If we can get a certain amount of return on our money, we will expand our airline. If we cannot get that return on our investment, then we intend to go into some other kind of business.

We have seen that argument come up at least once, and that was the rationale in asking labor to take a look at being party to manufacturing the A scale/B scale system, which you may be familiar with. Certainly, we, as a responsible labor union, had to look at both sides of those issues.

But if here is a successful company that says our first duty is to our stockholders and we will pursue other types of businesses if it is advantageous for us to do so, then certainly I would find it very difficult to place myself in the position of those that are running KLM and SAS to see what is in their hearts. But the bottom line is

that I would be very suspicious of foreign investment in U.S. airlines.

Mr. OBERSTAR. My sense expressed to the preceding panel is that foreign carriers who invest in U.S. airlines are not doing so for a return on their dollar investment, but for a measure of control of the U.S. carrier and a means of entrée to the U.S. market in a way they can't get through their bilateral agreements. Once they have that entrée then they will be able to exercise broader competitive effect in the U.S. marketplace.

Let me just repeat the question I asked earlier about foreign investment in U.S. carriers, which you have partially addressed. Is it useful, is it a good move for the U.S. Government to relax its standards on foreign investment in U.S. carriers, if, as Mr. Checchi stated to our committee a few days ago, the problem of the air carrier industry in the U.S. is liquidity and more investment will ease that liquidity? Is the best salvation foreign investment by foreign carriers in the U.S.? Is it a foregone conclusion that there is no beneficial opportunity for the U.S. marketplace to invest in U.S. carriers, and what limits then, if any, should be put on that investment from abroad?

Mr. SEHAM. If I may answer that. It is the position of our association that there are alternate sources of investments available to the airline industry. And we can think of nothing so poignant or recent as an attempt by Mr. Trump to make a corporate raid on American Airline. Now here American Airlines is fat, happy, and sassy, and prospering, scarcely an evident target for a takeover. Yet, Mr. Trump, by putting the necessary monies together—this is before the crash of the Taj Mahal—put together at least a viable proposal to American Airlines, a proposal that prompted the carrier to consult with the pilot organization in an effort to solicit support to stave off Mr. Trump.

Similarly, in the Eastern Airlines situation, over the course of the development of that bankruptcy, there were several proposals from interested financiers and financial interests based in the United States to take over that carrier. And we can second-guess by looking historically as to what happened as to whether there were unfair or unwise obstacles placed in the path of that investment.

The point that I'm making is that I think there are still good sources of investment in the United States from United States sources and it is not necessary to invite the evils of I would say at least excessive foreign investment in our airlines, which would bring to bear all of the distasteful consequences that we've discussed today. So I think certainly the association would not take a position against investment—I mean, \$1.50 is all right—but certainly we would be opposed to removing the 25 percent restriction that is now in place.

Mr. OBERSTAR. Well, the 25 percent restriction has literally been circumvented by the Secretary's decision on KLM-Northwest. The Department still maintains that that's not control. I would say that it must just be a coincidence that KLM began flying the route Amsterdam-Minneapolis/St. Paul when for ten years previously Northwest was not interested in serving it and didn't want anyone else serving it either. Then, all of a sudden, with that route being flown

by KLM, there is an aircraft sharing arrangement by Northwest and KLM. That certainly must be the world's greatest coincidence or the result of some interest by the partner providing \$400 million of the \$700 million equity in Northwest Airlines.

Mr. MATTOX. We've heard quite a few comments on the same subject today. I think that there have been some very excellent concerns raised about the whole issue. Again, I can't put myself in the heart of the manager of KLM, but certainly I share your concerns about all those areas.

Mr. OBERSTAR. The Securities and Exchange Commission has a rule that when an investor reaches 5 percent of a company's stock that person must notify the SEC and, thereby, notify the public of its acquisition. Five percent isn't control. Five percent is a far distance from twenty-five percent. But it is significant enough in the real world of investment to be so important an investment as to be tantamount to control. If no one else has more than 1 percent, and one person has 5 percent, that person certainly speaks with great authority in the decisions of the corporation.

Mr. MATTOX. In the case that Mr. Seham referenced in the Trump attempt to buy out American Airlines, I am certain that the amount of shares that were represented there were much less than 25 percent, I don't know the exact number but it was not even close to that number of shares.

Mr. OBERSTAR. I just think the investors are being very creative, very inventive in getting around the existing law. You put these financiers to work and they find creative ways of getting what they want, and what they want is access to the U.S. market without very many restrictions.

The Chair recognizes the gentleman from Pennsylvania, Mr. Clinger.

Mr. CLINGER. Thank you, Mr. Chairman.

I would agree with you what the Secretary did in terms of the Northwest-KLM deal. We really didn't get a whole lot in return for what was offered in the way of making that investment possible. That was why I introduced my bill, saying, okay, if we're going to have foreign investment above 25 percent, then I view it as a market opening effort. If we are going to do that, then we obviously have to get something in return; in fact, we should get an absolute quid pro quo in return. Therefore, under my bill there would be no possibility of this happening unless there is a pro-competitive agreement with the same conditions applying to a U.S. citizen wanting to invest in a foreign airline, that they be permitted to do that if they are permitted to do it here. In other words, it would provide for an even playing field in terms of investment.

As has been indicated today though, this issue may be somewhat moot since the Secretary approve the KLM-Northwest deal, and we haven't seen a rush of potential investors coming in prepared to bail out other ailing airlines. I was interested in your comments because I have not seen where there has been that kind of availability of domestic capital either. It seems to me that capital formation in this country has been woefully short of the tremendous needs out there and the airlines are competing with all kinds of other capital demands that are being made on them. That was one of the reasons I thought, well, it may not be productive but at least we

ought to provide the possibility for foreign investment as long as we get an even deal out of it.

Mr. SEHAM. I think the problem with American investment in the recent past is that it has been opportunistic and not productive. In other words, there have been monies around from the likes of Mr. Trump, who would leverage small investments into big opportunities but are not in the race for the long haul. I think that shortage of serious investment is a problem for domestic operators. Certainly, we would never say never say never say no to any situation or any opportunity which might preserve a significant American carrier. So I think your proposed legislation, if I can presume, is a wise piece of legislation in that it provides an opportunity to save something of value which would otherwise be lost with as much safeguard as is possible. I think though you are right in suggesting that, at least for the time being in the world's economy, there may not be a sufficiency of what I call serious investment, while there always will be the availability of opportunistic investment which one has to be careful about embracing.

Mr. CLINGER. It seems to me that any investor willing to invest under the terms of my bill would have to be interested in more than just getting access to our market because they will have to give as much as they get out of a deal like that.

Captain Mattox, what would be the feeling of your organization with regard to Congresswoman Horn's idea that American Airlines in its purchase of the TWA be willing to absorb X number of TWA pilots?

Mr. MATTOX. We would be basically opposed to it. There have been a number of examples of route transfers or the transfer of pieces of operation that have taken place over the past number of years and they have been handled in various ways. Some were that the transfer of the employees has been part of the deal, some not. But generally speaking, most of the transfers have not embraced that issue. Our feeling is that the profit or the monies with which one airlines purchases another one's routes, gates, whatever, are really the monies that have been earned by the employees of the carrier making the purchase.

We also feel that if you brought employees with those routes, it would terribly complicate the already difficult seniority structure that is built into the pilot ranks. So we would not be in favor of that.

Mr. CLINGER. And as I do understand it, in the Pan Am sale to United there has been some acceptance of some of the Pan Am pilots?

Mr. MATTOX. I am not fully knowledgeable about the history of that. I am certain that was a negotiated thing. Maybe Mr. Seham knows more about that.

Mr. CLINGER. I just wonder what the difference might be.

Mr. MATTOX. I don't know who initiated it. Do you know anything about that, Marty?

Mr. SEHAM. No, except it that it was a very small aspect of the entire transaction. American has, as a matter of policy which the pilots have cooperated in, adopted the practice of internal financing and internal growth. Unlike the other carriers who contributed to the demise, in a way, of the Ozarks and the Frontiers and the

other smaller airlines, American has grown by self-generating capital and self-generating it in cooperation with the employee group and the pilot group. On those rare occasions where there has been growth by absorption, there have been agreement to integrate the seniority list, and that came about in the Air Cal merger. But if what American is buying is an aspect of the operation, it is not buying the operation itself—it is not buying the aircraft, it is not buying the operational infrastructure, what have you, but is simply buying an aspect of the operation—the pilot group does not feel that it is wise or proper or fair to have a different group with a different record of contribution to its carrier participate in the growth that has been self-generated.

Mr. CLINGER. But, it is pretty clear that American will need additional flight personnel to man these new routes, and here's a substantial addition of traffic.

Mr. SEHAM. There is no net loss to the pilot community in jobs. In point of fact, take the Pan Am situation, contrary to what one of the gentlemen said, I think from ALPA, it is not the most senior men who leave but it is the most junior men who leave. The most senior men may be bumped down to a lesser position or a less desirable route, but they will not be the ones without the jobs. The ones without the jobs will be the ones who, by the domino effect, are at the tail end of the seniority order, and those will be the people who the expanded carriers will typically be looking to hire. They will be hiring them as a matter of voluntarism rather than as a matter of—

Mr. CLINGER. So what you are telling me is that there is a likelihood that former TWA pilots will in fact be employed but they will be employed as free agents and not as a part of the arrangement.

Mr. SEHAM. Exactly.

Mr. MATTOX. And at the bottom of the seniority list.

Mr. CLINGER. Okay.

Mr. OBERSTAR. That's a question that Ms. Horn had asked if I would raise, and the gentleman from Pennsylvania has already raised it. In short, the answer is that the senior American pilots don't want to have competition from senior TWA pilots. If you had a straight seniority integration, that's what would happen.

Mr. MATTOX. There's a—

Mr. OBERSTAR. I understand this. I grew up in the iron ore mining company in northern Minnesota where each mine had its own—I mean, the same union represented several mines and if one mine shut down, a person could transfer to another mine but at the bottom of the seniority scale. The union finally negotiated with mining companies to have area-wide seniority so that if you transferred from the Godfrey mine to the Old Frazier mine, you wouldn't transfer from job class 14 to job class 3 at the bottom of the rung, you would transfer from job class 14 to job class 14. You know what happened? For a very long time that was rejected and as mine by mine shut down, guys who were in their mid-50s had to transfer from a shovel runner to a track gang pounding spikes with 19 and 20 year old kids. I understand what's going on. I don't blame you for it, but I just—

Mr. SEHAM. We've eliminated pounding spikes from the contract. But seriously, in the situation we are actually describing, which is

the sell-off of a piece of Pan Am, it would not be a conflict of senior against senior because the senior Pan Am pilots would stay on the job—

Mr. OBERSTAR. But with Pan Am.

Mr. SEHAM. With Pan Am. Instead of flying New York to London, they may be flying New York to Miami, or some other fairly good piece of the system. The people who would be affected would be the people at the bottom of the seniority list and those people typically would be picked up by other carriers.

But the American pilots' position is that the senior pilot on Pan Am is certainly entitled to fly from New York to Miami, but it would be unfair to the contribution which the American pilot has brought to his carrier to have this Pan Am pilot, by virtue of the discontinuance of the London route, fit into a structure which gives him an opportunity to fly around the world at a far, far, far increased quality of job life than he would have enjoyed if he had stayed with Pan Am.

Mr. OBERSTAR. I understand that. That is not the main focus of our inquiry. Our real question is in these broader policy issues, although this is certainly very important—very important when it gets down to whose job is at stake.

I would just close with a thought that from the standpoint of a foreign carrier looking at the U.S. marketplace, it seems to me the most attractive place for investment is in a regional carrier, apart from those major carriers that are on the edge, a regional carrier that you could invest in and grow, develop, for that time when the Administration throws all caution aside and lets investment grow in the U.S. and removes the restrictions on trade in the U.S. and a compliant Congress goes along with them. I can see foreign air carriers looking ahead to that point and saying our best investment is in the strong regional carrier, develop a strong domestic base in the United States, and then build our international service. That would be the smart area for them to invest in. That's what I am concerned about and that's why I think our policies need to be proactive and prospective rather than reactive.

Mr. SEHAM. In a way, that tracks the development of American Airlines which, up to a very few years ago, was known as a domestic carrier really bereft of foreign routes. What it did was to capitalize on the earnings that it made in the domestic service to buy its way, push its way, elbow its way into international routes and international transportation until today it is a prime competitor on the world scene. This isn't far off the mark from what you are suggesting as a possible development.

[Mr. Vogel's prepared statement appears on page 160.]

Mr. OBERSTAR. Quite right. And on that very perceptive observation, we will close this hearing to reconvene at 10:30 a.m., Thursday, to continue this hearing.

We appreciate the testimony of all our witnesses today, and we thank you for your patience for what has been a very long day. Thank you.

The committee is adjourned.

[Whereupon at 4:41 p.m., the committee recessed, to reconvene at 10:30 a.m., Thursday, March 21, 1991.]

PREPARED STATEMENTS OF WITNESSES

STATEMENT OF

Captain Randolph Babbitt, President

Air Line Pilots Association, International and
Vice President, Transportation Trades Department, AFL-CIO

Before the
Subcommittee on Aviation
Committee on Public Works and Transportation

U. S. House of Representatives
March 19, 1991

Review of International Aviation Policy
and
Bilateral Agreements

Good morning. I am Randolph Babbitt, the President of the Air Line Pilots Association (ALPA). ALPA, which represents over 43,000 pilots at 44 airlines, appreciates the opportunity to appear before this Subcommittee today to present its views on international aviation policy and bilateral agreements. I am also testifying in my capacity as the Vice President of the Transportation Trades Department of the AFL-CIO, which is composed of 25 affiliated unions representing millions of workers.

It is certainly appropriate for the Subcommittee to be examining the topics on its agenda today. They merit careful consideration. ALPA believes that globalization -- the international expansion of U.S. carriers and their integration with carriers of other countries -- will be the salient motif in

the evolution of our air transport industry over the next decade. Indeed, the importance of international operations is already apparent. In the last half of the 1980's, revenue from international operations of U.S. airlines grew by nearly 15 percent a year, more than double the rate of growth from domestic operations. Maintaining that growth will be important now that our domestic market has matured, particularly because international operations contribute disproportionately to the bottom line. For example, in 1989 United Airlines derived only one-fifth of its revenue but over one-third of its operating profits from its Pacific operations. At Northwest Airlines the comparable figures were one-third and four-fifths. The current multitude of route sales indicates forcefully the importance U.S. airlines place on being best positioned for such growth.

As we confront the challenges posed by globalization, ALPA believes it is essential to establish and keep in sight some clear objectives. ALPA submits that a principal objective should be to provide a United States air transportation system to serve and benefit the traveling public that is (1) safe, financially sound and independent; (2) capable of competing in the global market; (3) capable of maintaining and increasing quality jobs for our citizens; and (4) capable of recapitalizing itself.

How we achieve this objective is a common question for all of us here.

Certainly one thing we should do as we work to answer this question is to keep in mind the lessons of past mistakes. The 1980's was a painful time for U.S. airline employees. There is hardly a pilot working today who was working for a certificated carrier in 1978 that has not gone through a merger, and a significant proportion of those pilots have had their carrier, and in many cases, carriers, go bankrupt. Many of us believe that the mergers and bankruptcies were the foreseen and unforeseen consequences of deregulation and its rushed and flawed implementation, and many of us also question how real and durable the alleged benefits of deregulation are. That is why we are skeptical of the calls for rapid international deregulation.

That is not to say that ALPA is opposed to change. Not at all. But, as I said before, the goal of increasing both the flying opportunities and financial health of our air carriers must be kept clearly in sight.

Let me now address some of the key international issues. First is the question of whether air transport services should be brought under the General Agreement in Tariffs and Trade (GATT). The answer to this question has to be no. U.S. aviation interests have little to gain and much to lose by such inclusion. Several of the principles of GATT -- the most favored nation principle, the establishment principle, and the national treatment principle -- would place our carriers at a perhaps

insurmountable disadvantage to foreign carriers. Moreover, application of those principles could actually retard the liberalization of aviation services by eliminating the time-tested bilateral negotiating framework that has continued to obtain and extend service rights for U.S. carriers. In short, ALPA believes that application of the GATT principles to the aviation industry could well have a devastating effect on U.S. airlines. In that regard, Mr. Chairman, I would like to thank you and the other members of the Committee for your leadership in opposing the inclusion of aviation services in GATT. We believe that the introduction of H. Con. Res. 280 and the subsequent co-sponsorship of that resolution by over 180 members of the House sent a strong message to our trade negotiators. We only hope that they continue to heed your advice.

A second key question is what our policy should be with respect to foreign investment in U.S. air carriers. The Federal Aviation Act restricts foreign ownership of voting stock in U.S. airlines to 25 percent, limits the number of board seats and corporate positions foreign citizens can hold and has been interpreted by the CAB and DOT to prohibit foreign citizens from actually controlling U.S. airlines. The Act is not designed to prevent airlines from obtaining access to foreign capital markets, and ALPA fully recognizes that some of our airlines could benefit from injections of foreign capital. We do

question, however, whether foreign investment in and of itself is going to be a miracle cure for financially ailing carriers, and believe that there are several reasons why foreign control has been, and should continue to be, prohibited.

First, the Gulf War illustrates a very real need to protect our national security interests. A large portion of the military goods and personnel transported to the Gulf was carried by commercial airlines voluntarily provided by U.S. airlines under the Civil Reserve Air Fleet (CRAF). Foreign ownership raises important questions about the continued availability of CRAF service.

Second, transportation is a vital sector of the U.S. economy, comprising almost 18 percent of GNP. This industry is an integral part of the transportation system. If foreign control were permitted, valuable assets and resources could be diverted from U.S. to foreign airlines, potentially crippling our industry.

Third, the U.S. market is the largest aviation market in the free world, and U.S. carriers have a distinct competitive advantage over their foreign counterparts in many areas. Given that over the past decade the United States has dropped from being the world's largest creditor nation to being the largest debtor nation, do we really want to risk having another of American industry's crown jewels come under foreign control?

It is with these considerations in mind that we look with concern on DOT's recent hasty decision allowing KLM to invest up to 49 percent of the equity in Northwest Airlines. DOT is either naive or hypocritical if it thinks that a foreign investor is going to pour hundreds of millions of dollars into an airline without exercising control to protect its investment. Perhaps the most troubling aspect of DOT's decision, however, was not that it decided to raise the limit on KLM's permitted equity investment, but that it removed the administrative oversight that could have ensured that the equity investment would not be used to control Northwest.

A third question is what should our policy be with respect to the transfer of international routes. We believe that the transfer of international routes can, in certain circumstances, benefit the carriers involved in the transfer. We are concerned, however, about route sales that have adverse effects on the carriers involved and their employees. The sale of TWA's London route authority is a case in point. The routes at stake are certainly TWA's most valuable and are at the heart of a route system that the airline has recognized, in its own submissions to DOT, as the key to its future. TWA has presented no plan as to how it will use any proceeds of the route sale to revitalize the carrier, and ALPA believes that the sale will lead to an acceleration of the carrier's financial losses and its speedy

demise. Unfortunately, DOT has tentatively approved the sale, and I am afraid that the tremendous benefits we gave the United Kingdom as a result of the recently concluded "Heathrow succession negotiations" in exchange for being able to replace TWA and Pan American at Heathrow may make the ultimate outcome of the route transfer case foreordained.

A fourth major question that is under discussion is whether we should permit foreign carriers to engage in cabotage operations. The unequivocal answer to this question must be no. The likely outcome of granting cabotage rights would be foreign airlines entering our largest, most attractive routes -- most of which already have extensive service by U.S. airlines. In a stagnant domestic industry with many mature markets, this "cream skimming" would have the net effect of taking passengers off U.S. airlines and putting them on foreign airlines. There can be little doubt that the effect of cabotage on an industry that has averaged a two percent return in equity over the last ten years would be devastating.

In addition, Article VII of the Chicago Convention -- to which the U.S. is a signatory -- prohibits the granting of cabotage on an exclusive basis. Thus, if the U.S. grants cabotage rights to one country, it would set a precedent to be observed in all future bilateral negotiations. Now if you ask our government negotiators about this precedent, they would tell

you that if cabotage is given to one country, other countries can ask for it, but the U.S. does not have to give it to them. But ALPA has had enough experience with pattern bargaining to assure you that such a strategy will not work. The U.S. cannot give cabotage to one country without all other countries making cabotage a deal breaker in future bilateral negotiations.

There is one variation on the cabotage proposition that has recently been advanced that I would like to address specifically, i.e., the suggestion that U.S. crews fly foreign aircraft in U.S. domestic markets. Apart from the fact that such an arrangement probably would be inefficient and uneconomical, it has a major flaw: it does nothing to address the principal problem of cabotage -- the diversion of domestic traffic and revenue away from U.S. carriers.

A fifth key issue, and one that has specifically been designated as a topic of today's hearing, is the soundness of the bilateral negotiation process.

There has been a good deal of talk about engaging in multilateral aviation discussions. Until appropriate multilateral negotiating partners materialize, however, we believe such talk is premature. ALPA believes that as a general matter the bilateral approach to negotiating aviation agreements has been successful. United States carriers have gradually obtained more and more flying opportunities as the aviation

regimes governing international flying have become increasingly liberalized. Congress has appropriately established as the primary goal of our international aviation policy "the strengthening of the competitive position of United States air carriers to assure at least equality with foreign air carriers, including attainment of opportunities for United States air carriers to maintain and increase their profitability." We believe that with this goal as the polestar, our negotiators should be able to achieve additional opportunities for U.S. carriers to expand their international services. But as the recently unbalanced agreement with the United Kingdom demonstrates, there is no substitute for caution and close analysis when negotiating an agreement. If the U.S. had not limited access to Heathrow to Pan American and TWA in 1980, there would have been no need to ransom ourselves in 1991.

Finally, there is a matter that bears on many of the other international issues -- the fact that most foreign airlines are owned in whole or part or assisted by their governments. It is essential that our aviation policy does not place our privately owned carriers at a financial disadvantage in head to head competition with foreign carriers that receive government subsidies or benefits that they do not. Recent direct subsidies of several European carriers by their owner-governments and actions by the European Community to alleviate the effects of the

Gulf War are poignant reminders of the advantages that foreign carriers have. I have submitted some charts for the record that show the extent of pervasive and substantial government ownership of foreign carriers.

As to what Congress might do with respect to the issues I have discussed, ALPA has several suggestions.

First, Congress should continue to send a clear message to the administration that it will not accept a GATT agreement that includes aviation services. I would request the members of the Committee to oppose extension of the fast-track process that governs GATT to ensure that the Committee will have meaningful input into the process if aviation is included in a GATT agreement.

Second, Congress should amend the Federal Aviation Act so that significant foreign investment in U.S. carriers will be subject to prior review and approval by the DOT to ensure that a foreign entity will not have actual control over American carriers. Foreign persons who wish to acquire more than five percent of the voting stock or capital of an air carrier should be required to file an application for approval of the investment, and interested parties should then be afforded an opportunity to review and comment on the application. If there are material questions of fact as to whether the proposed investment would lead to actual control of the U.S. carrier, a

hearing should be required. Congress should also establish a set of factors to be considered by the DOT in deciding whether to approve the investment. Among these should be (1) whether U.S. investors can make investments comparable to the proposed investment in the airlines of the investor's home country, (2) whether airlines of the country of the investor are in whole or part state owned, (3) the possible effect of the investment on the ability to negotiate for increased opportunities for United States air carriers in the home country of the investor or other countries, and (4) the national security implications of the investment. Congress should also specify that if the investor is a foreign airline or person controlling a foreign airline, certain transactions such as the transfer of flying from the U.S. air carrier to the foreign air carrier would be indicators of prohibited actual control.

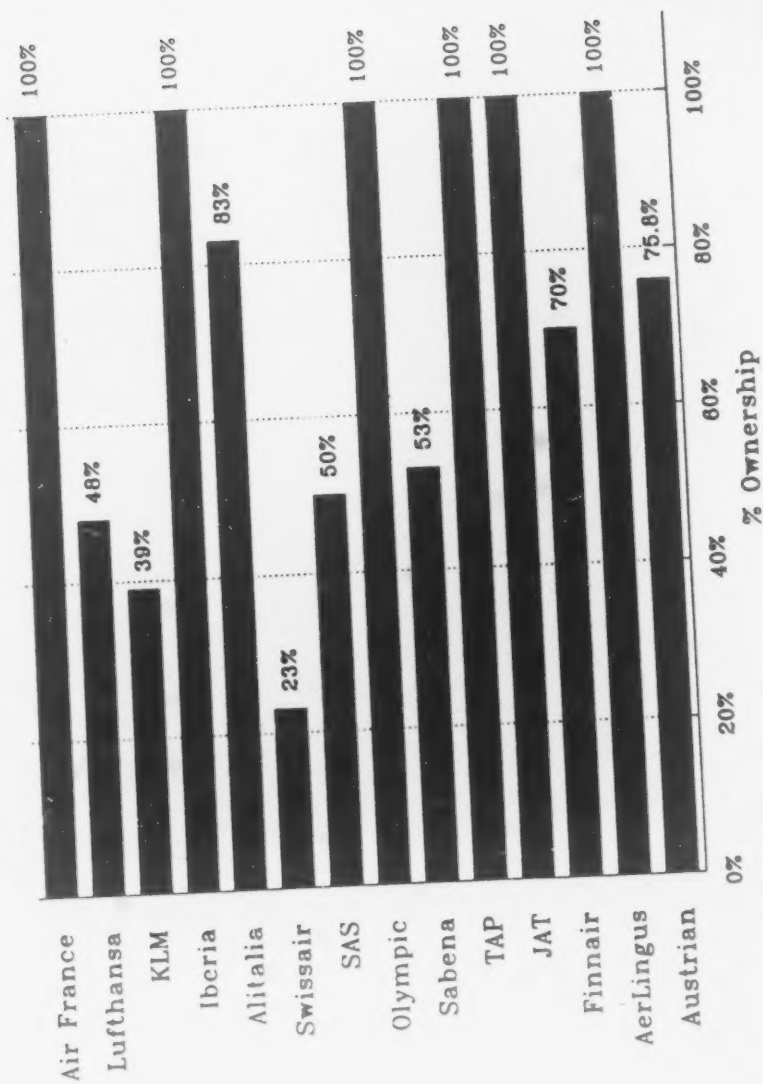
Third, Congress should amend section 401(h) of the Act to prohibit route sales that undermine the financial viability of an airline. Because route rights belong, at bottom, not to individual carriers but to the United States, any proceeds of their sale should be used to advance public, not private, interests. Any carrier that wishes to sell the rights that have been entrusted to it should be required to first submit a realistic plan of how it intends to use the proceeds of the sale to enhance its viability.

Finally, ALPA believes that the Department of Transportation should establish a more enlightened and humane policy with regard to the treatment of employees in connection with route transactions. This is especially true where carriers such as Pan American and TWA are in financial distress and are selling international routes for the sole purpose of getting cash to prolong their deficit operations. In these cases carriers seeking to selectively purchase valuable international routes should be encouraged to acquire the entire selling carrier including the employees. Alternatively, if the routes are purchased separately, the acquiring carrier should be required to take an appropriate number of employees as a part of the deal. If no buyers come forward under these conditions and the carriers are forced to go out of business, their routes should be distributed to applicants through the traditional route award process. We believe it is unconscionable that the valuable assets of a failing carrier can be "cherry-picked" for the benefit of a strong carrier, while the employees and their careers are left high and dry. Furthermore, under the current policy, the Federal Government is often left holding the bag in the form of huge unfunded pension plan liabilities, enormous tax revenue losses, and unemployment compensation liabilities when thousands of workers lose their jobs.

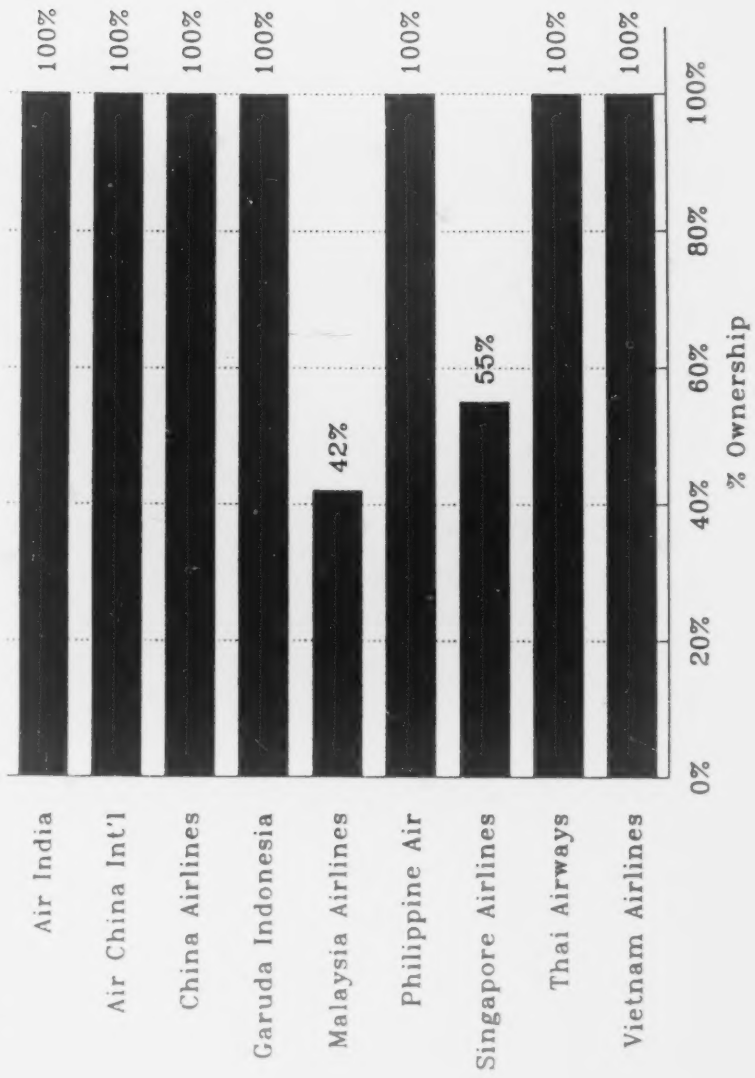
That completes my prepared testimony. Again, thank you for

inviting ALPA to testify today. I will be happy to entertain any questions the subcommittee may have.

GOVERNMENT-OWNED EUROPEAN AIRLINES



GOVERNMENT-OWNED ASIAN AIRLINES



STATEMENT OF
EDWARD J. DRISCOLL
PRESIDENT AND CHIEF EXECUTIVE OFFICER
NATIONAL AIR CARRIER ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON AVIATION
OF THE
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
OF THE
UNITED STATES HOUSE OF REPRESENTATIVES

INTERNATIONAL AVIATION

MARCH 19, 1991

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Mr. Chairman, members of the Committee, we appreciate the opportunity to set forth our views with regard to international aviation matters. As you will recall, we appeared before your committee in September of 1989 and at that time provided views with respect to international aviation as well as some domestic issues. The views we expressed and the recommendations we made at that appearance are equally as valid today as they were when we expressed them. We are therefore attaching a copy of that statement as an appendix to this statement as we believe it is sufficiently germane to warrant inclusion in the record of these hearings.

I am accompanied today by executives of some of the NACA carriers. These carriers, as well as other NACA carriers not represented here, have been involved in support of Operation Desert Storm. They have provided substantial capability for rapid deployment of forces, equipment and supplies which surely contributed to the outstanding success of the U.S. and coalition forces' operations in the Gulf War.

My presentation today will address:

- A. Operations in support of Desert Shield/Storm, lessons learned -- shortage of cargo capability.
 - B. International policy and bilateral matters -- the Case Law approach.
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C. Other international issues:

- (1) Non-availability of Title XIII premium insurance.
- (2) Foreign investment in U.S. airlines -- National Defense considerations.
- (3) Operation of non-certificated aircraft -- C-130.
- (4) Cabotage -- the inter-relationship of code sharing -- joint ventures -- foreign investment.
- (5) National Aviation Noise Policy.

D. Summary, Conclusions and Recommendations -- the future of international aviation.

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A. Operations in support of Desert Shield/Storm, lessons learned -- shortage of cargo capability.

U.S. air carriers operated substantial passenger and cargo capability in support of deployment of forces, equipment and supplies in support of Desert Shield and Desert Storm activities. NACA carriers from the outset, August 4, 1990, began operations into the Gulf area. Two of the NACA carriers were the first carriers to deliver troops and supplies into the area. These operations were expanded on a gradual basis and many of these carriers offered between 50 and 100 percent of their total fleets during this operation and are continuing to provide substantial quantities of lift in support of the redeployment of forces to the United States.

As you are aware, Mr. Chairman, it became necessary for the military on August 17 to announce the call-up of Stage I of the Civil Reserve Air Fleet. Voluntary contributions had been exhausted and ten additional wide-bodied passenger aircraft were needed to provide for the deployment of troops. At that moment the cargo capacity that was part of the Stage I call-up was not needed. There were 38 aircraft in Stage I. Many of those aircraft, however, were already operating on a voluntary basis when Stage I was activated. The operations continued from August through the month of December when, due to substantial build-up of forces as well as backlogs of cargo traffic at aerial ports, it was determined that more cargo capacity was required. Thus,

Stage II was activated on January 17, 1991 which provided additional cargo capacity but yet, even with that additional capacity, more cargo capacity could be used because of the tremendous amount of traffic that had to be moved in support of the Armed Forces. Several of the NACA carriers operated commercial flights for the movement of supplies into bases in Saudi Arabia in support of coalition forces, such as, the Kuwaiti and British forces.

Due to the shortage of cargo capacity, when the passenger requirements were satisfied, several carriers converted passenger equipment into cargo-capable aircraft to assist in the movement of the backlog of cargo.

It became evident from these operations that additional cargo capacity was required and the military, in conjunction with the State Department and other agencies, sought volunteer lift from NATO countries as well as from SATO countries and MAC offered to contract for any lift that would be available. I believe only two or three countries volunteered lift in support of the coalition effort. One or two foreign carriers offered to operate under contract to MAC but limited their operations to United States/Europe as these carriers would not fly into the Gulf area as U.S. civil carriers did.

This dramatizes the need for more civil cargo-capable aircraft in the U.S. inventory. However, expanding cargo capability can only

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be achieved when it makes economic sense. If you will recall, Mr. Chairman, the Department of Transportation, in conjunction with the Department of State, conducted a cargo study. That study revealed that the U.S. had only 36% of the total worldwide market and that in many markets U.S. carriers were out-distanced by their foreign competitors.

Mr. Chairman, it is our judgment that now is the time to revitalize that effort and to begin anew negotiations looking to broadening the cargo opportunities for United States airlines in international aviation in order that we can expand the civil cargo capacity so that it will be available for military use during any future emergency. Certainly, given the state of the economy, the U.S. cannot afford to add additional organic aircraft to the military fleet on the assumption that someday it will be needed. The tremendous costs of such a program -- acquisition of aircraft, support that must be assigned during peacetime, crews that must be trained, etc. -- would surely strain the budget. Expanding the civil cargo capacity would certainly be a more economic alternative in order to provide the required capacity. Expansion of that civil cargo capability can only be accomplished if U.S. airlines have additional opportunities, and such opportunities can only be made available through broadening bilateral agreements to ensure that we have fair and equal opportunity in foreign markets; that we have the right to operate charters on an unlimited basis without restrictions and that we have the right to inaugurate scheduled cargo service

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between all points on a very flexible basis.

Mr. Chairman, we believe the time has come to recognize that actions are necessary, from a Defense, DOT and U.S. Department of State standpoint, to quantify what must be done to improve the U.S. air carriers' operations into foreign markets and countries so that we can expand and enlarge the U.S. inventory of cargo-capable aircraft.

An interesting point, Mr. Chairman: Some of the civil cargo capacity used by the military are Stage 2 aircraft and these will need to be replaced between now and 1999 with Stage 3 aircraft if the U.S. is to maintain its present level of capacity. Given that additional requirement, such replacement and expansion can only be accomplished if it makes economic sense; thus, the need not only to study this issue, but also to take actions to implement the cargo policy of the United States that was prepared at your direction is essential.

B. International Policy and bilateral matters -- the Case Law approach.

The U.S. has established an international policy with respect to air cargo -- express freight. Mr. Chairman, you were instrumental in its development. However, the policy remains, in our judgment, unimplemented and necessary action on an industry/government coordinated basis has not been undertaken.

I think it fair to say that international aviation, unlike domestic aviation, necessarily requires some partnership between governments and their airlines. For the U.S. to be successful in negotiating an expanded cargo regime, such a partnership is essential as foreign governments with whom we have to negotiate usually work very closely with their designated airlines and they face us as a unit so that one cannot distinguish between government and industry with respect to our foreign partners. In fact, in many cases the foreign commercial interests dictate the position taken by the foreign governments.

It appears in the United States, however, before any particular action is undertaken, our government usually waits for consensus or for some one of the larger carriers to raise substantial issues that require resolution. In fact, we appear to work on a short-term approach rather than a long-term arrangement so that we attempt to solve problems as they arise rather than set in place a regime under which all interests in the air carrier market can effectively operate. As we have said before, in order to maximize transportation efficiencies for passengers and shippers, emphasis must be placed on maintaining competition among and between the various U.S. airlines which operate in the international marketplace. These include large combination and all-cargo scheduled airlines, small scheduled airlines operating in niche markets and charter carriers transporting cargo and passengers. Aviation regimes must be established which (1)

recognize that a variety of airline types are needed in order to react to shifting markets and the evolutionary needs of passengers and shippers; and (2) provide for balanced opportunity for both time-sensitive and cost-sensitive services. In order to provide for time and cost-sensitive services, charters must be provided for within the regimes whether or not there is a history of charter operations in a given market. The International Air Transportation Competition Act of 1979 sets as a goal the negotiation of competitive opportunities with other countries. This is a sound goal as it anticipates the ebb and flow of markets. We all recognize that our air cargo industry has been reborn in a spectacular fashion in our domestic market for competition is the rule of the sky as well as the highways. We must have an international regime similar to that which we have domestically and now is the time to plan for and take necessary actions on a government/industry basis to develop the required strategies which need to be in place to address a unified and consolidated Europe in future negotiations for air transport services.

Mr. Chairman, I headed this section "International policy and bilateral matters -- the Case Law approach". I used the Case Law approach advisedly as I think it is appropriate to focus on how our international policy is being developed. The recent agreement with the United Kingdom is an ideal example of a case in point. In that agreement we provided for Seventh Freedom traffic thereby permitting a United Kingdom carrier to operate between a

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third point and the United States. Another example is the foreign ownership interest approved in the Northwest case. There, for the first time by interpretation, the DOT overrode the 25% authorized in the Federal Aviation Act on the theory that the ownership interest above 25% is not a voting interest. Mr. Chairman, we need an international policy and we need a policy that we all clearly understand. One is not developed on a case-by-case basis but is a policy which all interested parties have had an opportunity to consider prior to its implementation.

Not much has been said about cargo in connection with the U.K. agreement but since we negotiated combination services, the United Kingdom can operate cargo as well as passengers between all of the points and under all of the expanded opportunities that we have provided. The expanded opportunities given to the United Kingdom in order to obtain authority for two U.S. carriers to be successors to Heathrow is extremely far-reaching and one can only judge how much we have given away in exchange for those rights when we determine how the United Kingdom employs the rights it has obtained.

The U.S., as you know, and many of the air carriers that operate, had additional interests in expanded opportunities that they wished to achieve. None of these have been addressed. Hopefully, they will be addressed when we negotiate an expanded regime with the United Kingdom. NACA believes that all of our requirements should have been addressed in one negotiation to preserve

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U.S. leverage for the benefit of all carriers, especially the smaller carriers that serve in niche markets or provide charter service. Under the U.S./U.K. agreement designations are limited and restrictive passenger charter rules limit operations.

OTHER INTERNATIONAL ISSUES

(1) Non-availability of Title XIII Insurance.

As a result of the Gulf War, aviation war risk insurance, both hull and liability, either became unavailable for operations into Israel and all of the points in the Persian Gulf or the cost of commercial insurance became so expensive that the air carrier could not recover its costs if it were to contract for insurance at these excessive rates. U.S. carriers, therefore, applied for Title XIII premium insurance. The FAA, which administers this program for the Department of Transportation, had a system established whereby each request had to be processed on an individual basis and whether or not Title XII premium insurance would be accorded was based on a determination by several agencies including DOT, the Department of State, DOD as well as OMB. In many cases Title XIII premium insurance was denied on the basis that the exposure was too great for the United States to undertake or it was denied on the basis of foreign policy considerations. Mr. Chairman, I am sure you will recall your personal involvement at our request when we were unable to obtain insurance for Tower Air to operate between New York and Tel

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Aviv. At that time, if you will recall, we had about 300 Israelis who wanted to return to be with their families. However, OMB remained adamant and refused to accept the exposure. On the other hand, the U.S. Government, through the FAA with all agencies concurring, did provide for war risk, both hull and liability, for Tower for operations from Tel Aviv to New York -- this on the basis that Tower was evacuating Americans. In order for Tower to compete with its foreign competitor, El Al, it was necessary to position airplanes for scheduled operations only from Tel Aviv to New York. Consequently, Tower had to tie other operations with their scheduled operation from Tel Aviv to New York, such as, depositioning to a point in Europe from the Persian Gulf and then positioning into Tel Aviv where Title XIII became available for the return leg. While we appreciate the Government making Title XIII available for the operations from Tel Aviv to New York, it placed Tower in a disadvantageous position vis-a-vis its foreign competitor, El Al. We believe that as long as airlines are able to operate between two points for which they are certificated to provide service, the United States Government should facilitate that operation by making Title XIII insurance available. It is our understanding that the Israeli carrier, El Al, had been provided insurance coverage by its government.

Another view expressed by the Government was that they could not from a policy standpoint since an advisory notice on Israel had been issued, authorize the operation from New York to Tel Aviv as

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it would be considered to conflict with their advisory. The State Department advisory did not preclude U.S. citizens traveling to Israel but rather suggested they reassess their travel plans. If an American wanted to go to Israel, all he had to do was book passage on El Al. Under those circumstances it appears that we were unduly penalizing a U.S. Flag carrier by not allowing it to meet its foreign competition.

In other instances in the movement of cargo to the Persian Gulf in support of the Kuwaitis, Title XIII insurance on a premium basis was denied.

Our conclusion, Mr. Chairman, is that there needs to be a revision of Title XIII so that it is available on an automatic basis to airlines that are conducting operations in accordance with their certificates. It would not be available, however, if the United States had, by order, precluded the operation of aircraft between any pair of points. In that case the air carrier's operations specifications would have restricted operations between those points. It appears only right and just that a U.S. carrier should be able to meet its foreign competition or deliver needed supplies in support of U.S. and coalition forces. I might add that with respect to non-premium insurance, there was no problem. The Department of Defense indemnified the Department of Transportation and the Department of Transportation made the non-premium insurance available without question. One of the provisions that seems to cause a problem is that with respect

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to establishing the rate for Title XIII insurance. The rate clause in Title XIII says one must take into account in establishing the rate, the risk involved. Well certainly, there are risks but the rate, in our judgment, should not be based on the risk. It should be predicated on the rate that was in effect commercially prior to the event that required Title XIII insurance. Likewise, we believe Title XIII should be amended so that it automatically is available unless the President of the United States disapproves Title XIII, not for economic reasons, but for foreign policy considerations which are enumerated and which govern all operations.

(2) Foreign investment in U.S. airlines - National Defense considerations.

The Federal Aviation Act of 1958 authorizes investments in U.S. airlines by foreign nationals. There is a limitation in the Act of 25% voting interest. An interpretation by the Secretary of Transportation now permits up to a 49% interest by foreign nationals in U.S. airlines as long as the 25% of voting interest is not exceeded.

The question of control is paramount in the consideration of foreign investment as well as National Defense considerations. NACA and its member carriers do not oppose foreign investment in U.S. airlines. We do, however, believe that any foreign investment cannot undercut National Defense considerations, especially

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when the welfare and security of the United States is based upon the use of civil air transports to augment military organic lift in order to effectively carry out war plans. We must assure ourselves that the U.S. airlines remain under U.S. control and that they are operated by U.S. personnel in order to be responsive to defense considerations. Consequently, in considering foreign investments, DOD should be a very active player so that the views of National Defense will clearly be weighed in any determination. It is clear in the Federal Aviation Act that National Defense considerations must be taken into account as the airlines are in existence, not only to serve the economic needs of the Nation, but also National Defense.

(3) Operation of non-certificated aircraft -- C-130.

The operation of non-certificated aircraft within the United States and internationally has continued to increase and these aircraft are at the present time attempting to compete with regular certificated aircraft -- aircraft which cost 10 to 15 times more than these non-certificated surplus military aircraft do -- are causing severe problems for all of, not only the NAACA carriers, but the other scheduled carriers that operate cargo systems.

There are many United States agencies involved in the disposition and regulation of these non-certificated aircraft. The agencies involved are: (1) Department of Defense, (2) Department of

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State, (3) Department of Agriculture, (4) Department of Transportation/FAA, (5) U.S. Customs Service of the U.S. Treasury.

Department of Defense sells surplus military C-130's. These are made available to individuals or through the U.S. Department of State to foreign countries for use by that country's military forces. The C-130 aircraft has an inherent military capability which places it on the embargo list by the U.S. Department of Commerce as well as by the U.S. Department of State. In order to remove one of these aircraft from the United States, an export license is required. That export license is handled through Department of State and possibly with some coordination with Department of Commerce. The regulation of the aircraft is handled by DOT/FAA and since it is a non-certificated aircraft, it has only a restricted category certification. In accordance with FAR 21.25 it can be used for such purposes as firefighting, crop spraying, but not for air transport services of a commercial nature; or to state it differently, the aircraft cannot be used for commercial operation -- the transportation of cargo -- for compensation or hire. There are numerous C-130's operating throughout the World that have found their way into the hands of some operators who attempt to operate them as civil aircraft for the delivery of relief supplies, movement of supplies for oil wells and many other situations, including the movement of cargo such as is the case in the Philippines, the case in Panama. My associate, Bill Langton, will go through this in detail for you, Mr. Chairman, and we will conclude with recom-

mendations that:

- (a) An aggressive program must be undertaken to ensure that C-130 aircraft are not utilized to compete with civil air carriers operating under Part 121 involved in air transportation for compensation and hire.
- (b) A system must be designed and implemented to regulate the use of these airplanes so that if an operator violates, he surrenders the airplane back to the U.S. Government and therefore loses the beneficial use of that for legitimate operations under the restricted category definition.
- (c) A system must be in place so that before the United States Government, through the Department of State, grants an export license for one of these aircraft, the potential use is evaluated to make sure that it is not going to be in violation of international law as the case involving the airplanes sold to the Philippine Government by Australia which sale was sanctioned by the United States Government through the Department of State. That sale authorized the use of C-130's, not only for operations within the Philippines, but also operations internationally to other countries, which was in violation of the Chicago Convention. Aircraft cannot be used for

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civil purposes for the movement of cargo for compensation or hire in international operations unless it is a certificated airplane. The C-130 is not certificated. Therefore, it is in violation of Article 31 of the Chicago Convention.

We are asking for a level playing field so that an operator who picks up an airplane under a grant program from the Department of Agriculture for firefighting purposes does not put that airplane into commercial operations.

As I mentioned, Mr. Chairman, Bill Langton will give you more details on this and hopefully the Committee will undertake a review of this and propose that the government agencies involved immediately move to tighten the distribution of these airplanes and the right of recovery of these airplanes should the operator who obtains them utilize them for purposes other than for which they were authorized.

- (4) Cabotage -- the inter-relationship of code sharing -- joint ventures -- foreign investment.

Any discussion of cabotage has to consider code sharing joint ventures, foreign investment as these three elements have a direct bearing on cabotage operations. Under the law, as presently enacted, cabotage, except

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in exceptional situations, is prohibited. However, code sharing by which foreign airlines operating into the U.S., U.S. airlines operating into foreign countries can effect arrangements whereby each can operate to all points that it is certificated to serve and serve those points by an arrangement with an existing carrier. Joint ventures permit airlines to arrange the use of seats on one another's airline through blocked-space arrangements or other related types of cooperation. The foreign investment in airlines, such as is the case of KLM in Northwest Airlines, permits investment up to 49% in a U.S. airline which, in and of itself, gives the foreign carrier such an investment that it is participating in the operations of the U.S. carrier and through its investment can accrue substantial benefits.

We must consider that all of the arrangements enumerated above are inroads into cabotage. While cabotage is currently prohibited by law except in the unusual situations, proposed cabotage operations need not be rejected out-of-hand. In fact, to the contrary, in negotiations which are forthcoming with Canada, cabotage issues will be addressed and in our submission to the Government concerning these negotiations, we recommended that the U.S. keep an open mind with respect to cabotage, analyze proposals made, determine the benefits to U.S. consumers, shippers, etc., as well as to U.S. airlines, vis-a-vis

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the benefit that is to be derived by the Canadian carriers and to look at the issue of comity and reciprocity so that if the Canadian carriers were to have cabotage in the U.S., the U.S. carriers would have to have cabotage within Canada. Once the parameters are defined and an analysis made, only then can you determine what benefits and detriments would exist vis-a-vis the proposals that may be made.

NACA and its member carriers intend to keep an open mind until we have all the facts and based upon the facts presented, the analysis made, then and only then, take a position with respect to whether cabotage in that situation would be beneficial or detrimental.

The issue of cabotage will have to be addressed in connection with negotiations with the EC. The EC has proposed very restrictive conditions surrounding cabotage and has proposed to label some of our Fifth Freedom rights as cabotage. It might well be to the benefit of the United States to consider a North American approach to cabotage. We would be negotiating vis-a-vis the EC from a North American operation not just the U.S. This could increase U.S. leverage.

Since we have not begun negotiations with the EC, it is

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difficult to imagine what the proposals may be once the EC has competence to negotiate on behalf of the European block countries that comprise the EC. Consequently, it is important to develop a strategy in advance of these negotiations as to what positions we will take with regard to cabotage and hopefully, in our negotiations with Canada we will have been able to focus on these major issues and have been able to determine, based upon the facts presented, whether cabotage is or isn't in the beneficial interests of the United States. If it is of a great benefit to the United States, then I am sure that the competent authorities in the U.S. will be proposing a revision to the laws which will give the Congress the opportunity to view these matters and determine whether, in their judgment, cabotage is appropriate for the U.S. In all of these situations the underlying theme must be: How does it affect National Defense? Does it weaken the U.S. carriers or does it strengthen them? We need, as we have said before, a substantial build-up in our civil cargo capability and whether cabotage will aid in that objective or detract from it is a matter that needs to be determined.

(5) National Aviation Noise Policy.

As you will recall, Mr. Chairman, when we appeared before your committee in September of 1989, we recom-

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mended that the United States needed a National Aviation Noise Policy. We are pleased that the Congress has enacted the Aviation Noise and Capacity Act of 1990. As you know, two NPRM's covering the phase-out of Stage 2 aircraft and access regulations have been issued by DOT. We are presently studying these and will file comments by the due date, April 15. We are hopeful that as a result of the comments that we will provide and that others will provide we will, in fact, have a national aviation noise policy which will establish once and for all that the Federal Government has pre-empted this area of noise and that only the Federal Government has the authority to impose rigid rules and phase-out criteria and/or approve restrictions. We trust that airports, airlines and all will cooperate in the endeavor to ensure that we have a uniform policy that is effective at airports throughout the United States so that it does not adversely impact upon interstate commerce. Likewise, we trust that the U.S. in fashioning the rule governing foreign carrier operation into the United States with respect to Stage 2, will be predicated upon comity and reciprocity and hopefully bilateral arrangements that will spell out the rights of the U.S. carriers in foreign countries so that they will not be more restrictive than the U.S. rule on foreign carriers operating into the United States.

D. Summary, Conclusions and Recommendations -- the future of international aviation.

If the past is prologue to the future, then we can only assume that there will be further consolidations in the aviation industry and that eventually we will have three or four mega carriers operating the scheduled service network of the United States. There will also be a few niche carriers performing scheduled service and a large number of small airlines providing cargo and passenger charter service throughout the U.S. and worldwide. To achieve this, as we have said before, the smaller carriers need to be nurtured if they are to continue in the marketplace as we do not believe many, if any, new entrants will enter the market, given the cost of entry. The CRS systems are controlled by the mega carriers which control the marketplace. The U.S. will probably be restricted to those carriers in the marketplace today and it is absolutely essential that we provide the opportunity for these smaller carriers to expand their operations on a phased basis into selected markets, markets that will support competition, including London, Rome, Milan, Athens, to name a few, all major capitol markets so that there will continue to be competition between the U.S. mega and niche carriers and charter operators for the benefit of consumers and shippers. Given the foreign investment authorizations that have been approved to date, code sharing, joint ventures, we assume that the U.S. carriers are headed for globalization; i.e., involve multinational corporations as the owners of these airlines.

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We must repeat here that such operations should only be approved and found satisfactory to the maintenance of a sound transportation system if National Defense considerations are not compromised. National Defense must be one of the main elements that the U.S. considers when it acts upon proposals or negotiates arrangements. We must get away from a Case Law approach in negotiating bilaterals and establish a policy on which our national air transportation system is predicated.

Finally, Mr. Chairman, we recommend that:

(1) Government agencies involved with the distribution and/or regulation of non-certificated aircraft be directed to develop a plan for control of these airplanes and to submit it to your committee for review.

(2) Government agencies responsible for international negotiations be directed to provide the forum and means for initial consensus development through strategy meetings (as opposed to pre-negotiation meetings) with the industry for the development of a negotiating framework for cargo, passenger and charter services so that a policy will be in place, based upon industry input as well as National Security requirements, prior to conducting international negotiations. Such is essential to eliminate the Case Law approach through which agreements are negotiated without full consideration of the impact on industry or National Security.

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(3) The Department of Transportation be directed to give priority consideration to applications by small carriers for scheduled service and to aggressively pursue the development of expanded charter opportunities, both cargo and passengers, for U.S. carriers.

(4) The Congress consider the changes we have recommended for Title XIII premium insurance to assure immediate availability in time of need by U.S. air carriers.

Mr. Chairman, that concludes my remarks. My associates have short statements to make following which we will be pleased to entertain questions.

**BEFORE THE
U.S. HOUSE OF REPRESENTATIVES
PUBLIC WORKS AND TRANSPORTATION COMMITTEE
SUBCOMMITTEE ON AVIATION**

**Statement of
Vance Fort
Senior Vice President -
Governmental and International Relations
World Airways, Inc.
March 19, 1991**

Mr. Chairman and Members of the Committee, I am Vance Fort, Senior Vice President, Governmental and International Relations, World Airways. I appreciate the opportunity to testify before you today concerning the international aviation policy of the present Administration. The Committee's focus on the bilateral agreement reached last week between the United States and the United Kingdom concerning the transferability of Heathrow Airport landing rights is particularly timely and important. It is troubling in the extreme to witness the Administration handing over valuable and unprecedented economic opportunities to British carriers simply in exchange for the continued "right" to an American flag presence at Heathrow.

Mr. Chairman, we do not begrudge United, American, Pan Am or TWA the benefits bestowed upon them by this recent agreement. Nor do we oppose the liberalization of the international air service rights of foreign carriers to serve the United States. We are concerned about the apparent willingness of the

Administration to "take care" of the big U.S. carriers at any cost and to do so without even a semblance of a long range pro-competitive international aviation policy consistent with the whole of the Declaration of Policy detailed in Section 102 of the Federal Aviation Act.

Indeed, it would appear that the Administration has fixated on sub-paragraph (4) of the Declaration of Policy which speaks to "[t]he placement of maximum reliance on competitive market forces ..." to justify almost any scheme devised by large carriers to obtain new route authority, to buy and sell existing authority, to buy and sell slots and gates and generally to trade assets and equity between them to meet their strategic considerations without regard to the public interest.

Gone is the vision and emphasis of past administrations on sub-paragraphs (9) through (12) of the Declaration of Policy namely : (i) to encourage actual and potential competition for efficiency, innovation and low prices, (ii) to encourage entry into markets by new carriers, (iii) to promote, encourage and develop civil aeronautics and a viable, privately owned United States air transport industry and (iv) to strengthen the competitive position of United States air carriers to at least assure equality with foreign air carriers.

Gone also is the feeling throughout the aviation community that the unpredictable could happen; that the Departments of State and Transportation were on the side of the little guy, and on the side of competition, and would flex their considerable muscle in pursuit of opening up markets and leveling the playing

field for all participants. Today a kind of cynicism pervades this city and the industry.

Today, it seems we accept the failure of deregulation to remove barriers to entry, to produce a growing number of innovative low cost, low price, service-oriented carriers, and to spread inexorably around the globe. Today the passion is not competition, but globalization, not small but big, not innovation but strength, not bilateral confrontation but accommodation, and not the consumer but the market.

Mr. Chairman, although the total story is not as black and white as just painted, this is our overwhelming perception of the Administration's policy, and this policy has left smaller carriers like World anxious to see the pendulum swing back.

These are rough times for everyone in the aviation industry -- large and small carriers alike. Publicly, the Administration has taken the position that the airlines will have to weather the current crisis without governmental assistance. However, despite the rhetoric, the government is doing much to help certain carriers stay afloat, primarily by allowing the sale of routes and slots. In an indirect way, a government bailout of the industry is in progress, with the sale of public rights -- route authority and airport access -- substituting for direct financial assistance.

This aid is limited. It benefits only those members of the scheduled airline community whose operations previously allowed them to obtain these scarce and

valuable public rights. These rights have never been evenly distributed, and they are becoming even less so as weaker members of the scheduled carrier industry conduct their own private carrier selection proceedings to sell them off in order to keep flying. Moreover, under present practice, scheduled carriers continue to enjoy a favorable claim on the distribution of these public benefits.

If the scheduled carriers are encountering economic turbulence, imagine the predicament of the nonscheduled operator. Nonscheduled carriers face the same high fuel prices, the same falloff in traffic, the same exorbitant insurance costs. But they have no route authority or airport slots to sell off to the highest bidder, and thus no ready source of cash to tide them over until traffic picks up again. If the present crisis in the airline industry means further consolidation among scheduled carriers, it threatens their nonscheduled competitors even more severely.

The purpose of my remarks is not to ask that nonscheduled airlines receive special consideration. I ask only that nonscheduled operators receive the same consideration from government policymakers as their scheduled counterparts. This means a recommitment of international aviation policy makers to advance the interests of the nonscheduled carrier with vigor.

There are a number of areas where the interests of small and nonscheduled carriers have been given questionable support. Let me briefly summarize a few serious cases of governmental neglect.

International Route Proceedings

Recent allocations of international route authority have revealed a persistent bias in favor of larger carriers to the point where smaller carriers are alienated from the process. Over the past two years, DOT has not made a single international route award of any significance to a small carrier.

This is a far cry from the early days of deregulation when international routes were routinely awarded to innovative carriers such as World, Air Florida and People's Express. The present favoritism towards larger carriers is so pervasive that smaller carriers rarely bother to apply for available routes.

World withdrew its application for scheduled all-cargo authority to Japan after realizing it could not possibly justify the expense of a major route proceeding given the virtual certainty that the authority at stake would wind up with a large carrier. It is ironic that DOT considers smaller carriers "too risky" to be awarded significant international route authority when many of the carriers who have received such rights are the very same carriers who are selling them today to the highest bidder.

Giveaways

It is bad enough that small carriers rarely receive international route authority; worse yet is the willingness of the Administration to enter into agreements so loaded with benefits for foreign carriers that there is little left for future negotiations. Smaller carriers like World have been hurt by these one-sided

agreements favoring foreign carriers. The U.S. paid dearly in order to gain access to Heathrow for United and American -- no one else stands to benefit from that deal. Indeed, the longstanding cries for improvements in the U.S.-U.K. bilateral regime and additional U.S. carrier services to and through London and Hong Kong have undoubtedly been prejudiced, notwithstanding Secretary Skinner's statement that "[t]his agreement should be seen as a prelude to more important talks in the near future to liberalize the aviation relationship between the U.S. and the U.K." If our negotiators were unwilling to show resolve with the British on a point as fundamental as the right to a U.S. presence at Heathrow (regardless of the color of the U.S. carrier's livery), why should we hold out expectations that any resolve will be demonstrated by our negotiators to prosecute the more difficult task of liberalizing the aviation bilateral. Somewhere along the way, our negotiators lost sight of the fact that sometimes, no deal is preferable to a bad deal.

It also appears that little thought was given to what the U.S.-U.K. deal means in terms of European integration. Will the Heathrow deal set the pattern for future talks with other European nations or with the European Community. If the Administration shows the same inclination to reach a deal no matter what the cost, smaller carriers have every reason to fear that their long-term interests will be sacrificed in favor of the short-term requirements of the scheduled airlines.

Recall also that the negotiations with Japan in 1989 produced an extremely objectionable agreement that gave Japanese carriers new rights to operate cargo

service to the U.S. without commensurate all-cargo opportunities for U.S. operators. Recently, the United States had to renegotiate the right to exercise the puny cargo opportunities the United States did secure in 1989. It may be argued that no additional payment was made. But who can dispute the fact that a precedent was established that in the future will require our negotiators to secure Japanese agreement to slot time changes -- not to mention slot increases. As for further improvements in the exceptionally restrictive bilateral agreement with Japan, the prospects are certainly not favorable over the near term.

What the present Administration has not given away at the bargaining table it has given away in recent policy pronouncements opening up the U.S. market to competition from abroad without commensurate benefits for U.S. carriers in foreign countries. A prime example is the decision by DOT to allow foreign carriers meeting certain criteria to serve U.S. points on an extrabilateral basis. As stated above, World is not opposed to a policy of greater access for foreign carriers as long as that policy results in greater opportunities for our own carriers. In the particular example of allowing foreign carriers to operate to so-called "underserved" communities, DOT could have accomplished the same end by requiring foreign carriers to first explore code-sharing or wet leasing agreements with domestic operators. These communities would have received the benefits of new international service while U.S. carriers possibly would have gained from the

additional demand for their services. It should be noted that no other country unilaterally grants extrabilateral rights of this scope to U.S. carriers.

Charter Rights

Too often in the past, the United States has negotiated bilateral agreements that only address the requirements of scheduled carriers. Charter rights are left for "subsequent negotiations" to be held at an unspecified future date. As a result, nonscheduled carriers frequently have to apply for operating authority on a flight-by-flight basis, virtually eliminating the possibility of long-term contracts with substantial customers. Charter rights should no longer be the step-child of bilateral negotiations; in the minds of U.S. negotiators, they should stand on an equal footing with the needs of the scheduled operator.

Recent agreements have given charter operators no reason to believe their fortunes in bilateral negotiations are improving. In the bilateral relationships with two of our nation's biggest partners -- Japan and the United Kingdom -- the charter regimes are respectively painfully inadequate or nonexistent. The unwillingness of U.S. negotiators to press their foreign counterparts on charter matters is a glaring failure of international aviation policy which places nonscheduled operators at a severe competitive disadvantage.

Fifth Freedom Charter Operations By Foreign Carriers

World and other nonscheduled operators have become increasingly alarmed by DOT's apparent willingness to grant Fifth Freedom charter rights in an unrestricted fashion. World asked DOT last December to clarify its policy on Fifth Freedom charter requests by foreign carriers, but so far DOT's reaction has been total silence.

It is not enough that "paper" reciprocity exists between the United States and some of the countries whose carriers seek these Fifth Freedom rights. The United States should not open the largest aviation market in the world to applicants whose countries offer no real benefits to U.S. carriers. Before approving such applications, DOT should require not just theoretical reciprocity but real reciprocity and real opportunities for U.S. carriers, particularly since these operations involve one of the few areas offering a special niche for nonscheduled operators.

In addition to the issues addressed above, there are at least two other areas involving U.S. international aviation policy that are matters of concern to nonscheduled and smaller carriers. Let me briefly address each of these concerns.

Foreign Investment

World welcomes the recent decision of Secretary Skinner to relax the restrictions on foreign investment in U.S. airlines. Domestic sources of equity for investment in airlines have all but dried up. Under the present circumstances, opening up new sources of private investment, albeit foreign investment, is a far better policy alternative than unfairly permitting a few privileged carriers to profit from the sale of their common carrier rights. Just as clearly, foreign equity is preferable to carrier stagnation and/or bankruptcy.

Buy America

World and other nonscheduled carriers played a critical role in the success of Operation Desert Storm. The military's requirements in the Persian Gulf far exceeded its own airlift resources and civilian carriers were called upon to assist in the effort. On several occasions, however, the military has attempted to satisfy its requirements by turning to foreign carriers.

Under the Fly America Act, government agencies are required to use domestic carriers for their airlift needs unless they provide a certification that sufficient lift is unavailable from U.S. sources. Technically, those requirements have been adhered to. Foreign carriers under "contract" with private parties or foreign governments, however, carried significant tonnages of war material and military-related supplies from the United States to the Persian Gulf. Having so

recently proven their value in the war effort, World and other nonscheduled carriers should not be "rewarded" with a de facto change in the policy that requires U.S. military supplies to move on U.S. carriers. World asks that the Subcommittee strictly monitor compliance with the Fly America Act by all agencies of the U.S. government.



STATEMENT OF
WILLIAM G. LANGTON
PRESIDENT
SOUTHERN AIR TRANSPORT, INC.
BEFORE THE
SUBCOMMITTEE ON AVIATION
OF THE
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
OF THE
UNITED STATES HOUSE OF REPRESENTATIVES
INTERNATIONAL AVIATION
MARCH 19, 1991



Mr. Chairman, Members of the Committee:

Southern Air Transport appreciates the opportunity to put forth its views with regard to international aviation matters. As a member airline of the National Air Carrier Association, we fully support the positions expressed earlier today by Mr. Driscoll, and can add little to most of his comments.

There is, however, one particular area of great concern to us, and that is the issue of military aircraft entering the private sector. Although the remarks I will make apply for the most part to the military C-130 aircraft, they will be equally relevant to other military aircraft such as the C-141, C-5, and so forth, if these were to be retired from active military service.

There is no doubt that in the past former military aircraft have entered the private sector successfully and productively. Probably the most notable example of this was after World War II, when the famous Dakota C-47 saw service literally by the thousands as the civil DC-3. Several hundred of these aircraft are still flying.



SOUTHERN AIR TRANSPORT

There are, however, some important differences between the phenomenon of the DC-3 and what is occurring today with the military C-130 aircraft. Mr. Chairman, I am now referring specifically to the recent uncontrolled funneling of surplus military C-130 aircraft to private individuals and organizations in the United States, and most distressingly, in some cases abroad.

There are significant differences between what happened with the DC-3 and what is happening now with the C-130:

First, the DC-3 had been conceived from the outset as a civil airliner, and was adapted for military use because of its versatility. Second, thousands of these aircraft were suddenly surplus to the Armed Forces, and coupled with the availability of pilot entrepreneurs and the explosive growth of the commercial airline industry as the World recovered from the War, were a benefit to the passenger and cargo needs of the U.S. and other nations, who were starting to build an entire industry from the ground up. The infusion of these aircraft was a boon to either existing or start-up carriers, who did not have access to nor the time to wait for new equipment to be manufactured. Third, and perhaps most important, the political situation after World War II was obviously different from that of today. I suspect that



little concern was felt at the time about the potential for C-46 aircraft to be utilized by individuals, organizations and countries in both illegal activities as well as to support aggressive actions against weaker neighbors. Operation Desert Storm should be a sobering reminder of what can happen when military equipment and sensitive technology is provided to aggressors. The Allies are fortunate that Saddam Hussein did not have access to C-130 aircraft, which incidentally turned out to be an extremely valuable asset to the United States as well as the other Allies.

Since its birth in the 1950's, the C-130 has proven to be a unique aircraft, and over two thousand have seen service with the United States Military and its Allies. Because of its unique characteristics, the C-130 aircraft has always been considered to be sensitive militarily, and its use and disposition is supposed to be tightly controlled, as mandated by the U.S. Department of State's own International Traffic in Arms Regulations (22 CFR 120-130).

Additionally, the C-130 has never been issued a U.S. Standard Aircraft Type Certificate. As a result of the lack of a Standard Type Certificate, it is ILLEGAL to operate a C-130 aircraft in commercial use for compensation or hire, except under

**SOUTHERN AIR TRANSPORT**

some very unique circumstances, primarily as aerial water bombers to put out forest fires in unpopulated areas. Incidentally, the prohibitions against commercial use of the C-130 are not only in the United States. Internationally, the International Civil Aviation Organization (ICAO), clearly prohibits use of non-certificated aircraft for commercial operations. In short, it is ILLEGAL under U.S. and international law to use the C-130 aircraft in commercial operations.

There are many good reasons for these regulations. However, the primary reason is that civil aircraft are subjected to exhaustive safety and design testing prior to being approved for commercial service, and once in commercial service, must be kept at all times on maintenance programs appropriate to ensure public safety. Military aircraft, on the other hand, are managed and maintained under rules unique to military needs. There is no doubt that U.S. military aircraft maintenance is safe and superb, however, the rules are different because the requirements are different. The records and procedures are different as well. This is not a problem while an aircraft is on active duty with a military organization. It becomes a huge problem when this airplane is parked in "boneyard" for years, and then enters the commercial world with an incomplete or absent technical history.



SOUTHERN AIR TRANSPORT

Until recently, virtually no C-130 aircraft were in non-military hands. What few were not actually serving actively were normally in military storage, such as at Davis-Monthan Air Force Base. A very few older models were on display in museums. Over the past two years, however, and most recently in the past twelve months, a disturbing trend has begun to manifest itself. Over thirty old C-130 aircraft, and I am referring to 1950's vintage aircraft, which had been in mothballs for years, have suddenly been popping up in private hands. What is most distressing is that the supposed safeguards to prevent this are either being ignored, or more seriously, deliberately circumvented.

I can provide specific details upon request, but I can tell you of the following recent occurrences:

- * One or possibly two C-130's are currently operating in Angola, flying military supplies for the Angolan Government. We have strong evidence that one of these aircraft may even be sporting a forged registration number!
- * Another aircraft has apparently been illegally exported to Panama, and its current whereabouts are unknown.

U. S. Customs has advised they are investigating both of these incidents, but it is unclear what steps they can take to repatriate the aircraft, since they are now physically out of the country.
- * Illegal use of Department of Agriculture Forest Service aircraft is also troubling. Over the past two years several surplus C-130 aircraft have been provided, at no cost, to some private companies for the specific purpose of fighting

**SOUTHERN AIR TRANSPORT**

forest fires. This is an excellent program, and is very cost-effective. However, the paramount condition of this free transfer is that the new owner is prohibited from using the aircraft for anything other than fighting forest fires in the U.S. In addition to the inherent unfairness of operating free government-furnished aircraft in competition with the private sector, these aircraft are supposed to be physically in the United States, at all times, to protect our national forests and rangelands from devastating fires. Yet I must tell you that several of these aircraft are now flying in the Mideast, in flagrant violation of the terms upon which the new owners got these free aircraft. The U.S. Department of Agriculture appears unable to take the necessary action to enforce its own regulations which clearly state that if the aircraft are used for anything other than fire fighting, legal action will be taken.

Mr. Driscoll has already mentioned several other cases of illegal use of C-130 aircraft, and we have a wealth of information to substantiate the occurrences, which are ongoing.

Mr. Chairman, Southern Air Transport operates a fleet of L-100 Hercules aircraft. Although this aircraft is very similar to the C-130, there is an important difference. The United States Federal Aviation Administration has issued a civil type certificate to the L-100. The aircraft is manufactured to different specifications. As the possessor of a civil type certificate, individual L-100 aircraft are then eligible for a Standard Airworthiness Certificate, which in essence is the FAA seal of approval designating the aircraft as safe and approved for civil use.

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Southern Air Transport has made a considerable investment in its fleet of L-100 aircraft. In fact, we are the World's largest operator of the L-100, and are recognized as the leader and pace setter in our niche position in the industry. In addition to being the premier air transporter of outsize cargo into remote areas, particularly flying food into famine-ravaged areas of Africa, and support of oil exploration such as in the remoteness of Papua New Guinea, Alaska, and the like; we are also staunch supporters and participants in the United States Civil Reserve Air Fleet (CRAF). Our L-100's played a vital role in logistic support for Desert Shield and Desert Storm, both within the United States as well as overseas. Desert Storm has reinforced the absolute criticality of having a strong and viable airline industry in the United States, which can be called upon in times of national need.

Mr. Chairman, we are not seeking any unfair competitive advantage. We can compete with the best, as long as the game is played on a level playing field. As you stated in your letter to Secretaries Baker and Skinner on this very subject in June, 1989:

"...the Aviation Subcommittee of the House Public Works and Transportation Committee is extremely concerned that the United States promote a sound commercial air transportation system...we



do not believe it equitable that non-certificated airplanes which are acquired at bargain basement prices be made available for sale to individuals and/or governments that may seek to use them in competition with U.S. certificated air carriers...".

In this same letter, you requested that the Secretary of Transportation advise you of what actions DOT and FAA planned to take to insure that C-130 aircraft are restricted in their operations and to prevent their leaving the United States as civil aircraft to operate in international navigation.

Regrettably, Mr. Chairman, despite assurances from many agencies that concrete steps would be taken, these aircraft continue to leave the Country and find their way into commercial aviation.

Individual U.S. Government agencies have been cooperative, in particular the FAA. However, the problem will persist because no one agency appears to have total oversight of the many aspects of this issue.

The FAA, for instance, can police activity in U.S. airspace, but has no say overseas. The Department of Defense disposes of aircraft but has no means of policing what happens when the



aircraft enter the private sector. The Department of State issues export licenses despite the prohibition against use in commercial aviation. U.S. Customs cannot stop an aircraft from leaving the U.S. and cannot get it back once it does.

We would like to recommend that one Federal Agency be designated as the absolute clearinghouse for the disposition and use of C-130's, and other military aircraft that may find their way into the private sector. Additionally, specific regulations should be issued that must include a requirement to clearly mark all such aircraft and associated documents including certificates, transfer documents, export licenses, etc., with the pertinent restrictions. Lastly, enforcement action must be initiated against those individuals and organizations who either permit aircraft to enter into illegal operations or who conduct illegal operations, and the penalties must have some teeth in them.

Mr. Chairman, thank you again for allowing us to present our thoughts.

STATEMENT BY THE ALLIED PILOTS ASSOCIATION
TO THE HOUSE SUBCOMMITTEE ON AVIATION

March 19, 1991

Submitted by
Captain Fred R. Vogel, President

Allied Pilots Association
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**STATEMENT BY THE ALLIED PILOTS ASSOCIATION
TO THE HOUSE SUBCOMMITTEE ON AVIATION**

This statement is submitted on behalf of the Allied Pilots Association. Our organization is the certified representative of some 8500 airline pilots in the employ of American Airlines. It is also the representative of pilots flying with certain American Eagle operations.

APA is the largest unaffiliated pilots' organization in the United States and is one of the largest independent labor organizations of any kind in the country. We are also distinguished by the fact that membership in APA is entirely voluntary; there is no union shop or any other compulsion to join. Yet, over 98% of the eligible pilots enjoy membership.

The purpose of our appearance here is to ring a warning bell in the ear of Congress to alert you to a wholesale giveaway of American resources combined with a debasement of airline employee working conditions - all in the name of cabotage hiding under the mantle of free trade.

Those who do support cabotage - and that includes the President of American Airlines - argue that the United States will receive its quid pro quo for allowing foreign flag carriers access to our domestic route system. Those cabotage supporters suggest that our reward will be access to internal foreign

traffic. That may well be - but the critical question is whether the price of the exchange is a fair one or whether Uncle Sam is being a sucker. Even when we know the price for the supposed expansion of U.S. flag airlines, the further question of who pays the price still must be answered.

Transportation services are the product of the bases which they serve. The passengers and cargo being carried from Chicago to Frankfurt must arrive for the flight over a network of roads and rails which have been put in place by the taxpayers' dollars. Once at the airport, the goods and people are submitted to a complicated system of security and distribution that will put them at the right gate, at the right time, with the right ticket in hand - again, this airport facility, its parking facilities, internal tram ways, service areas, warehouses, and loading equipment represent another massive investment by the American public in air transportation.

Finally, the aircraft is ready to go aloft and to do so it then must enter the electronic system of air traffic control which will maintain separation and safety for the flight as it enters the stream of traffic generated by both private/general aviation, our major airlines, and the myriad of smaller airlines that feed traffic to the trunk. It is Uncle Sam, again, who trains the traffic controllers and maintains the Federal Aviation Administration and the National Transportation Safety Board in

their efforts to maintain the highest standard of safe transportation that it is possible to achieve. All of this is "infrastructure" upon which the airlines rely in order to effect their transportation obligations.

Certainly, there are infrastructure installations which accommodate other forms of foreign commercial enterprise. Thus, when a Japanese motor car company opens a plant in the United States for the manufacture of its vehicles, it, too, must depend upon the roads and rails to receive raw material and to ship out its product. The difference between the Japanese automobile manufacturer and a Japanese airline seeking cabotage is that in the former case the investor leaves something for the community beyond tire tracks. The manufacturer brings employment in the building process; he employs local labor as his personnel, he pays taxes to the local community which go directly to the costs of highways, police, and all the other services and facilities that come within local governments. Finally, the community even has some protection against failure because the plant and facilities that are built remain where they are set and certainly constitute an asset which has become a part of the national and local inventory. The foreign airline which carries a passenger from Chicago to San Francisco makes no contribution and leaves no asset dedicated to the facilitation of that flight or the maintenance of the aviation infrastructure.

An allowance of cabotage will necessarily degrade the working conditions of American Airlines' employees. Again, the watchword of the cabotage promoters is "competition". However, on the cost side of the profit and loss statement there is very little area for effective competition. It may be that areas of competition exist in the service category but discrepancies and deficiencies are subject to remedy. On the cost side, fuel charges will be at market rates, the same limited mix of aircraft will be employed, capital requirements will be met by the same system of banking, local fees and expenses are effectively fixed by third parties. There is, however, one area where costs need not be equal if the carriers have their way - that is, labor costs. It needs no statistical proof to satisfy this body that an airline captain flying for Air India makes wages and benefits a tiny fraction of what our public would agree is proper for an American Airline pilot. Yet, those scant wages will allow the Indian pilot to enter into the thin layer of economic elite in his Third World home. Indeed, the Indian would be living a life full of many luxuries about which any American would scarcely dream.

At the other end of the spectrum are the employees of certain carriers flying under foreign flags whose countries provide the highest measure of governmentally financed social welfare systems. Thus, the issues of who pays for medical expenses that are now in the forefront of American labor

relations' discord are not even problems for the German or Scandinavian worker who knows that his own government will provide to him, as a matter of right, a full range of medical services. In such cases the wage and benefit package between the airline and the worker need not contain any element of cost to provide the necessary benefits. Yet, we can count on American Airlines to assert that benefits must be reduced and employees must bear a larger share of costs to meet the "market rates" set by the Germans.

If the scenario of cabotage were allowed to play, we are certain that the First Act would be the American carriers' wails that foreign competition has a cost advantage; the Second Act will be a pitiful plea for the institution of "market rates" for American Airlines' employees and the Third, and climactic Act, will be the economic confrontation between the American carriers contending that they cannot survive unless their employees accept Indian Airlines' working conditions met by a confrontation from those employees as they desperately fight to maintain an American system of living.

Not only would the cabotage flying depress American employees' standard of living, but it would also drill another hole in the strength of the American trade union movement. The law, as it now stands (subject, we hope, to revision), excludes from the processes of the governing United States' labor law,

(the Railway Labor Act), airline employees whose work is exclusively sited abroad. Thus, if U.S. citizen pilots flew from New York to Paris and turned over the cockpit to European pilots who would continue the flight from Paris to Rome or even to U.S. citizen pilots flying such a segment, the employees flying that second segment might well not be subject to the Railway Labor Act and would, thereby, forego union representation by APA or any other American union. Thus, there would be contrast in pay, working conditions and union representation on the same transportation system.

Consider the problems you have with the two-tier system of payment to American labor under which there are "A" pilots and "B" pilots doing the same thing under different rates generated by the same contract. That situation has created long term turmoil in the industry which is only now beginning to get sorted out. These problems pale beside the prospect of pilots turning over their aircraft to foreign crew members who utilize opportunities generated by the American pilots' efforts but taken away from them by what is, in effect, a commodity market in employee sweat.

A further apprehension we have lies in the prospect of nourishing a limitless staff of potential strike breakers who can be used to undercut the American pilots' struggle for any

contract improvement that does not meet the Company's own uncontradicted test of what is appropriate.

All of the problems we have discussed become exacerbated when we pause to think about the capacity of foreign state owned carriers' manipulation of the market in order to achieve goals not necessarily related to the operation of the airline itself. Take an example easy as holiday packages. Iberia Airlines may well want to induce American tourists and their dollars to spend a few weeks in sunny Spain. The national interest of that carrier's government is to stimulate spending in the country itself on lodging, meals, transport, souvenirs, and the like. To the extent the Spanish government can control its airline's pricing, it would be a good deal for the Spanish to lop \$100 off the fares from Phoenix to Chicago, connecting to Iberian's international flight to Madrid, in order to get the tourist to Spain. Of course, this puts competitive pressure on the domestic airline flying from Phoenix to Chicago and it will soon appear that the way to "ease" that pressure is to transmit it to the employees by a reduction of their wages and benefits.

The example we have just given may not be the most felicitous, but it was made to illustrate the point. Many foreign international carriers, either owned or controlled by their government, will be put in a position to influence the

pricing of domestic air service in the United States in order to gratify a host of different motivations.

APA appreciates the opportunity to submit these views.

March 19, 1991

Allied Pilots Association

By Captain Fred R. Vogel
President

STATEMENT OF JEFFREY N. SHANE
 ASSISTANT SECRETARY FOR POLICY AND INTERNATIONAL AFFAIRS
 U.S. DEPARTMENT OF TRANSPORTATION
 BEFORE THE
 HOUSE PUBLIC WORKS AND TRANSPORTATION COMMITTEE,
 SUBCOMMITTEE ON AVIATION
 MARCH 19, 1991

Mr. Chairman, Members of the Subcommittee, I appreciate this opportunity to be here today to report, briefly, on recent developments in U.S. international aviation policy and bilateral negotiations. At the conclusion of my statement I would be glad to answer any questions you may have.

Since I last appeared before this Committee in October to testify on U.S. international aviation policy, the operating environment for international aviation has been extraordinarily difficult. Although fuel costs have declined markedly to levels approximating levels that existed prior to Iraq's invasion of Kuwait, the war has had a significant negative impact on the level of U.S. carrier transatlantic traffic. In addition, a soft U.S. domestic economy contributed to an already difficult operating environment. With the success of our armed forces in the Gulf and the end of hostilities, it appears that the fear of terrorism is abating. The media is reporting increased interest on the part of

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travellers in flying again which should mean near-term improvements in air traffic.

Summary of Market Performance

Although the latter part of 1990 was a difficult time for the U.S. international aviation industry, results for the full year showed good traffic gains in most areas. According to DOT data, on a revenue-passenger-mile basis, in 1990 U.S. carriers' international passenger traffic increased almost 15 percent over 1989. This increase was distributed very unevenly throughout the world: transatlantic traffic rose eight percent, transpacific traffic surged 24 percent and Latin American traffic increased a strong 14 percent. The strong 1990 passenger traffic increases were achieved despite the fact that the transatlantic market sustained declines of five percent for both November and December. The really severe downturn in international traffic for U.S. carriers occurred in February when, according to data provided to us by the Air Transport Association, passenger traffic plummeted about 27 percent. Fortunately, the world situation has improved dramatically and U.S. carriers can look forward to more normal traffic levels.

The international air cargo market for U.S. carriers in 1990 was nearly flat, with scheduled freight-ton-miles increasing overall by just three percent. The transatlantic market for the year was

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down about four percent while transpacific cargo rose eight percent and the Latin American cargo market grew over seven percent. In January, overall international freight dropped almost eight percent from year earlier levels.

Although international traffic was up for the U.S. airline industry in 1990, it is estimated that for both international and domestic operations, the industry lost two billion dollars for this period, making it the worst year ever for this industry. How could this have occurred considering that its international traffic was up? A big part of the explanation is that international passenger traffic accounts for only about one-quarter of the industry's business and the U.S. domestic market in 1990 was not as strong as the international market. Also, industry costs soared when fuel costs escalated. I would add that high operating costs, especially debt service and labor costs, no doubt contributed to the losses experienced by some carriers.

MAJOR ACTIVITIES

I would like to turn now to the major activities and decisions of the Department in the past several months. In summary, I would first say that our principal goal has been to assist both the airline industry and our communities in their quest for enhanced air transportation opportunities in a rapidly evolving global world order.

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Our long-range goals are to establish competitive multilateral and multimodal regimes to replace the current bilateral approach to international aviation, which has been overtaken by economic unity in Europe, international marketing agreements, and multi-national business entities.

While this approach is intended for all sectors of the industry, we perceive that there may be possibilities of earlier results in the cargo sector. We are in the process of developing ideas for multilateral express freight agreements in markets where multilateral agreements might improve competitive opportunities for the U.S. transportation industry. As the committee is aware, integrated express freight delivery systems, a multimodal desktop-to-desktop concept, are now a rapidly growing segment of the air cargo business. We hope to engage some of our trading partners in an exchange of new ideas along these lines.

Foreign Investment and U.S. Citizen Ownership and Control

An essential tool of the industry is capital and the Department has recently taken steps to enhance our carriers' ability to meet their capital needs. In January, Secretary Skinner announced that the Department would significantly relax the administratively imposed restrictions on foreign investment in U.S. airlines. As you know, the current legislative restrictions on foreign

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ownership and control require that the president and at least two-thirds of the board of directors and other managing officers of an air carrier must be U.S. citizens and that at least 75 percent of the voting stock of the carrier must be owned or controlled by U.S. citizens. None of this is changed by the Department's recent initiative and Secretary Skinner has not proposed that changes to the current law on foreign investment in U.S. carriers be considered at this time. What we have done is refine the "control" test to allow U.S. airlines to attract more foreign capital. Under our new policy we will allow foreign ownership of equity up to 49 percent while keeping foreign ownership of voting stock to the 25 percent statutory limit.

We have also decided not to view debt as a control issue, unless the loan agreement provides special rights that imply control. We will also allow foreign membership on airline boards to reflect voting stock ownership and as long as representatives of foreign airlines do not take part in decisions affecting competition.

Our revised policy on foreign investment provides a number of significant benefits. Besides allowing U.S. carriers greater latitude in raising capital, it recognizes the important role that cross-border investments are likely to play in the development of global air transportation systems. It will enhance the ability of U.S. carriers to invest abroad. Beyond that, this initiative should also help open foreign routes to U.S. carriers.

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Program for Underserved Cities

Shifting now to enhancing the ability of U.S. communities to improve their international air services, the Department has continued to grant operating authority to foreign airlines of countries with which we have procompetitive, liberal bilaterals. In January, the Department granted KLM Royal Dutch Airlines exemption authority under this program to serve the Minneapolis/St. Paul-Amsterdam market. The grant brings to five the number of new services that have been authorized thus far under this program. The other services are KLM: Baltimore-Amsterdam; Swissair: Philadelphia-Zurich; Lufthansa: Charlotte-Frankfurt; and LADECO: Washington, D.C.-Santiago.

Recent Developments in Bilateral Negotiations

In the area of bilateral negotiations, over the last several months we have had a heavy negotiating schedule and have made significant progress with a number of our aviation partners in opening up opportunities for new or expanded services.

United Kingdom

I am pleased to be able to confirm that the U.S.-U.K. agreement reached last week not only solved the immediate issue of the U.S.

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ability to replace Pan American and TWA at London's Heathrow Airport, but it also guarantees to the U.S. Government the right to select two U.S. airlines for Heathrow service and to change those selections without further negotiation with the United Kingdom. In reaching the agreement, we ensured that the replacement airlines would be able to start off with the base of operations at Heathrow identical to that accepted by the British for Pan American and TWA. Although, for the next three years, the replacement airlines will not be able to grow as quickly as TWA and Pan American might have been able to, and I must underscore the word "might", they are guaranteed the opportunity to match the Heathrow services of their U.K. competitors. Moreover, as market demands warrant, they may operate additional flights to London's Gatwick and Stansted Airports.

In exchange, the British received a number of new benefits, including enhancements of their route rights and the opportunity for joint ventures with other European airlines. (We have prepared a written summary of the agreement for the record.) If U.K. airlines take full advantage of their new rights, we expect to see not only a more competitive U.S.-U.K. market, but also a more competitive transatlantic market in general. We have laid the foundation for innovative service arrangements and operating flexibility that reaches beyond the bilateral framework that has for too long restricted the development of a truly integrated global aviation market. In addition, the new code-share authority available to U.K. airlines within the United States could redound

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to the benefit of U.S. regional airlines that might be attractive code-share partners.

But this agreement is not the end of the story. Secretary Skinner is very much aware of the outstanding desires both of U.S. cities and of U.S. airlines for the introduction of new services in the U.S.-U.K. market. As the Secretary emphasized in announcing the resolution of the Heathrow succession issue, that agreement is the prelude to broad-ranging negotiations to liberalize the U.S.-U.K. aviation relationship. Both Secretary Skinner and the U.K. Secretary of State for Transport Malcolm Rifkind are committed to that objective, and we have agreed to begin liberalization talks within three months.

Canada

The first round of aviation negotiations with Canada are now tentatively scheduled for early April in Ottawa. At these talks, we will begin the difficult process of negotiating a watershed international aviation agreement to achieve the objective of creating a single aviation market for Canada and the United States. On February 12th, Secretary Skinner and Canadian Minister of Transport Lewis met in Washington to discuss a number of bilateral transportation issues. During this meeting Secretary Skinner and Minister Lewis reaffirmed the goals of the U.S.-Canada aviation initiative that was jointly announced last October 3.

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They agreed that it is important to the economies of both countries to succeed in achieving a liberal "open skies" bilateral aviation agreement as quickly as possible. We have agreed to consider the Canadian request for cabotage rights in the context of an "open skies" agreement. If we reach the conclusion that an exchange of cabotage rights is necessary and desirable, then, of course, we will need to seek the concurrence of the Congress through a change in existing legislation.

Japan

As the committee will recall, in November 1989 the U.S. and Japan reached an agreement to expand U.S.-Japan air services substantially, including, for the U.S., three new passenger routes and one all-cargo route to Tokyo. As a result of competitive carrier selection proceedings, four U.S. carriers were selected to operate these new routes. United was awarded Chicago-Tokyo, Delta received Los Angeles-Tokyo and American was granted San Jose-Tokyo. UPS was authorized to operate the all-cargo route.

All was proceeding smoothly until the selected carriers applied for landing slots at Tokyo's Narita Airport. They were initially granted slots at times of the day that effectively prevented these carriers from operating a marketable service.

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Pursuant to Secretary Skinner's direction, the Department informed the Japanese that until the U.S. carriers were granted slots that would enable these carriers to implement commercially viable services, the U.S. would withhold authorizations to Japanese carriers to operate new Tokyo routes Japan obtained under the 1989 accord. As a result, Japanese all-cargo services to Chicago were delayed several months. An interim solution to this problem enabled UPS and United, as well as the Japanese airlines, to begin service on a temporary basis. A more permanent solution to this issue was achieved last month as a result of talks in Tokyo. This was a difficult issue to resolve because of the severe congestion at Narita. Much of the credit for the positive outcome of the talks can be given to Japan's Ministry of Transport and the Japanese carriers. They demonstrated an impressive degree of cooperation in working to resolve this problem.

Other Countries

In addition, since October, the U.S. has met for negotiations with Nicaragua, Guatemala, Yugoslavia, Spain, Czechoslovakia, the Federal Republic of Germany and China. A U.S. delegation also met with a group of Central American Transport Ministers to discuss the potential benefits of procompetitive aviation agreements to Central American countries.

As a result of these talks, substantial progress was made toward liberalizing the operating environment with most of these

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countries. In the case of China, Yugoslavia and Czechoslovakia new agreements were reached.

Consultations are planned with Barbados, the Dominican Republic, Jamaica, Spain, Belgium, Switzerland, Germany and Italy. At present, talks are in progress with Thailand and Greece. We hope the talks with Thailand will result in an understanding on the principal aspects of a new aviation agreement. The procompetitive agreement we had with Thailand expired last November following Thailand's year-earlier notice of denunciation.

European Community (EC)

In January, Secretary Skinner met with Commissioner Van Miert of the European Community in the first meeting at secretarial level under the framework of the US-EC transportation dialogue.

In a broad discussion of liberalization, market access and foreign investment issues, both Secretary Skinner and Commissioner Van Miert expressed their commitment to building a more competitive transatlantic aviation regime, and to eventually bringing about direct US-EC negotiations.

GATT

As you know, the Uruguay Round was interrupted last December in Brussels when the United States and the European Community (EC)

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were unable to agree on how to reduce future EC agriculture subsidies. With the cessation in farm subsidies discussions came a halt in talks on services as well. Happily, recent U.S.-EC discussions on farm issues have been productive and the GATT talks have resumed. Therefore, the issue of how to treat aviation and maritime services in a GATT Services Agreement is with us again.

It became apparent in Brussels that not many nations had focused fully on the relationship between the MFN provision, which obligates GATT members not to discriminate among countries, and market access commitments. Without firm market access commitments, an MFN requirement would mean that countries with liberal trade regimes and open markets, such as the United States, would be obligated to provide open access while countries with less liberal regimes or closed markets could remain unaltered. Under such a scenario, a GATT service agreement would not provide much incentive to liberalize markets. Further, such an agreement could limit our ability to use unilateral measures to combat unfair restrictive practices by our transportation partners.

We firmly believe that U.S. international transportation markets are the most open in the world, and current U.S. trade practices reflect a liberal environment far greater than any incorporated in the obligations and principles of the proposed GATT services framework. Applying the framework to air and maritime services would enshrine in international law many of the anti-competitive

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practices and policies that the United States opposes every day on a bilateral basis, and that the U.S. has challenged successfully on a great many occasions.

Since it is the Administration's goal to provide opportunities for liberalized trade that will benefit U.S. air and maritime carriers in the future, we remain deeply concerned about the inclusion of such services in a GATT agreement. The current regimes that regulate U.S. air and maritime services, coupled with judicious use of our own statutes to combat unfair practices, are proven vehicles to advance our pro-competitive international transportation agenda.

The Warsaw (Montreal) Protocols

Turning now to another subject, we are continuing to work to gain support for ratification of the Montreal Protocols and the Supplemental Compensation Plan. The Department was instrumental in coordinating a revised Supplemental Compensation Plan, which, together with the Montreal Protocols to the Warsaw Convention, would provide for unlimited liability recoveries for U.S. citizens in international airplane accidents, irrespective of where, or on what airline, the U.S. citizen was traveling. On January 29, 1991, the Senate Foreign Relations Committee, by a vote of 13 to 2, again voted in favor of ratification of the Protocols, subject

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to implementation of the revised Supplemental Compensation Plan. The Department, and this Administration, considers obtaining Senate advice and consent to ratification of the Protocols a matter of high priority. As demonstrated by the aftermath of the tragic Pan American flight 103 bombing, and as emphasized in the findings of the Presidential Commission on Aviation Security and Terrorism, and the General Accounting Office Report, it is unconscionable to permit the existing \$75,000 Warsaw passenger liability limitation to continue. We are hopeful that the Protocols will come to the Senate floor for a vote within the next several weeks.

The CRAF Program

In closing my prepared statement, I would like to return to the circumstances created by the war in the Gulf and report on the role of the CRAF program in the military effort. In support of Desert Shield/Desert Storm, the CRAF airlift has, as of March 4, involved 25 airlines and over 3200 flights transporting over 300,000 people and 140,000 tons of cargo. About 63 percent of Desert Shield/Desert Storm personnel were moved on commercial aircraft; 27 percent of the cargo.

Clearly, the CRAF program proved to be a vital element of the war effort. The strength of the CRAF program is, of course, dependent

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upon the health and capabilities of the U.S. commercial airline fleet. Without a thriving international airline sector, we cannot maintain a strong CRAF program. This is one reason why it is critical that our international transportation policies serve to foster the economic health of this important industry. I can assure you that Secretary Skinner and all of us involved in this area at the Department of Transportation are committed to this objective.

This concludes my prepared statement. I would be pleased to answer any questions you may have.

ELEMENTS OF U.S.-U.K. HEATHROW AGREEMENT

(1) Two U.S. and two U.K. airlines of each Government's choice may operate from Heathrow to the United States. The choice of airline may be changed.

(2) The United Kingdom has four opportunities to add an additional U.K. airline at U.S. cities already being served by one or more U.K. airlines. (Maximum number of U.K. airlines at any U.S. city is three.)

(3) a. U.K. airlines may hold out service in the United States under code-share arrangements to all U.S. cities from which U.S. airlines hold out service to the United Kingdom.

b. Both U.S. and U.K. airlines may enter into code-share arrangements in markets where they have the right to operate their own aircraft.

(4) a. In addition to operating to Heathrow from the U.S. gateways named in the Agreement, U.K. airlines may operate service to Heathrow from any U.S. gateway city that is not also a gateway city for U.S. airlines (e.g., Pittsburgh, Tampa, Orlando, San Diego, San Juan).

b. U.K. airlines may operate to Heathrow from any U.S. gateway city if the flight operates via a third-country (for example, flights via Canada).

c. Both U.K. airlines at Miami may serve Heathrow (only one of the two U.S. airlines at Miami may serve Heathrow).

(5) a. U.K. airlines may own up to 50% of another EC airline and the U.S. will not question the nationality or control of the EC airline based solely on the U.K. ownership interest.

b. U.K. airlines are guaranteed approval, under certain conditions, of joint ventures with airlines of Belgium, France, Germany, Luxembourg, The Netherlands, and the Republic of Ireland. U.S. authorities will give sympathetic consideration to arrangements with other countries.

c. U.K. airlines may operate a limited number of flights from the United Kingdom via points in Belgium, France, Germany, Luxembourg, The Netherlands, and the Republic of Ireland.

(6) Western Hemisphere beyonds:

a. U.K. airlines may select five more of their U.S. gateways for service to Canada (seven U.S. cities are currently available for service between the U.S. and Canada).

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b. U.K. airlines may select five more of their U.S. gateways for service to Mexico City (five U.S. cities are currently available for service between the U.S. and Mexico City).

c. U.K. airlines may select three of their U.S. gateways for service to Venezuela, Colombia, Peru, Chile, Bolivia, and Ecuador (service between these countries and San Juan and between Atlanta and Venezuela, Colombia, and Peru is currently authorized).

(7) Pacific beyonds:

a. U.K. airlines may select three of their U.S. gateways for service to New Zealand, Singapore, Indonesia, Malaysia, Korea, Taiwan.

b. U.K. airlines received new rights to carry traffic between Seattle and Australia on seven flights a week.

(8) U.S. replacement airlines will receive the full benefit of the level of flights that had been approved for Pan American and TWA at Heathrow. The replacement airlines can not grow as quickly at Heathrow as Pan American and TWA could have (a match of British service rather than the ability to take the lead in adding additional flights); however, U.S. airlines will be able to offer the same number of Heathrow flights to each U.S. city as U.K. airlines do. In addition, the U.S. airlines may offer additional flights from Gatwick or Stansted, the other major airports serving London.

TESTIMONY OF
STEPHEN L. GELBAND
ON BEHALF OF
TOWER AIR, INC.

March 19, 1991

My name is Stephen L. Gelband. I am General Counsel of Tower Air, Inc.

Tower Air is a U.S.-flag scheduled international carrier. It operates scheduled B-747 service to Israel and to Denmark, Norway and Sweden and, in May of this year, will start service to Paris.

Tower Air also has been a very major contributor of airlift to our country's Desert Shield and Desert Storm operations -- and will continue those operations until all of our troops return home.

The company today operates five 747's and will shortly be adding a sixth.

The best best way I can describe Tower Air is to say that it is unique. Not particularly because it planned to be, but because of the extremely concentrated way that the air transportation market has become structured, and the unfortunate way that our government has fostered that concentration.

A year and a half ago I testified before you that just 10 years after deregulation opened the doors to competition, Tower Air found itself as the only surviving post-deregulation carrier that continues to operate scheduled international passenger service, and that its competitors were becoming fewer and larger. Now it is twelve years, and the same is true in all respects --

only more so. There are now even fewer and yet larger carriers, and many of those remaining are in bankruptcy or on the verge.

Tower Air has so far survived the additional concentration of our industry and the neglect of our government regulators largely by finding a few specialized "niches" in which to operate, and by vigilantly keeping its costs low and its management flexible. It, thus, is able to offer a high quality -- low cost service to the public in a few markets. And it is able to respond to the unexpected needs of our military immediately and often.

When passenger lift to the Middle East was required, we provided that. And when more cargo lift was needed, Tower converted two of its 747's to cargo configuration over one weekend and carried cargo to Saudi Arabia. We converted those planes back to passenger use two weeks ago, and are now helping to carry our troops back home.

The dedication and flexibility of this small airline also made it possible for it to be the only carrier other than El Al that continued to operate service from Israel to the United States throughout the entire war period. And today, Tower Air is still the only U.S. carrier that operates regularly between the United States and Israel.

I am here today primarily to express our serious concern that airlines like Tower Air not be allowed to become an entirely lost breed through continued government neglect. Unless we are given sufficient government policy nourishment to ensure that we can stay in business in the face of fewer, larger and stronger competitors, small, low-cost and flexible carriers like Tower Air

will not be able to stay in business to continue to provide the competitive spur to the rest of the industry that deregulation envisioned.

In Tower Air's case, this primarily means finding a way to enable us to expand into those few additional international markets where the company can exploit new "niches". We must be able to open up a new market every few years in order for the company to maintain its effectiveness in keeping its costs low and its prices down.

Our problem has been that because we are not huge like United or American, or old and familiar and palpably in trouble like Pan American and TWA, our interests keep getting lost in the shuffle of their competing interests.

We have targeted Spain, Greece, Italy and the U.K. as the markets that we feel we can successfully establish a "niche" in over the next several years. But our experience has been that we can't even get on our government's agenda for discussions with those countries. You saw vividly last week how far the DOT was willing to go with the U.K. to build up United, American, Pan American and TWA, and you also saw how willing it was to block out all other U.S. carriers from serving the U.K. in order to achieve that result. We had the same experience with Italy last year.

Negotiations with Greece start today and we have no assurance that our interest in serving that market will actually be advanced in those talks by the DOT. It is not so much that our government is purposely excluding Tower Air from these oppor-

tunities, but it is clearly more interested in furthering the interests of the mega carriers. Tower Air is simply not important enough to our policy makers.

But if that type of thinking keeps on, I can assure you that there will soon be no post-deregulation U.S. international carriers that will have survived the increasing concentration of our industry.

The policy which we would like to see translated into legislation -- or, at least a strong policy statement by your Committee -- is that the Department of Transportation be directed to give priority to applications for international authority from small carriers that have a history of providing low-cost competition -- both in terms of granting prompt regulatory approvals to such applications and in terms of negotiating the necessary correlative bilateral authority to enable the requested service to be implemented quickly.

We are concerned that if the importance of the role of the few remaining post-deregulation carriers is not given special emphasis in the future, the public benefits of deregulation will not be extended into the 1990's because such airlines will no longer be able to remain in business as viable competitors to the mega-carriers.

We do not believe that re-regulation is the answer to this problem. What is needed is simply a restatement of the priorities that the government should follow.

I would like to close with a few words about the Title XIII Premium Insurance program. When the coalition sent troops to the Middle East last summer, commercial war risk insurance was can-

celled for the industry and no airline was able to fly into that area. Pan American and TWA dropped out of the market entirely. Tower Air responded by turning to the FAA to obtain insurance for its flights to Israel under Title XIII.

Thereupon ensued one of the strangest intra-government arguments that I have ever seen -- the upshot of which was that Tower was allowed to have insurance for flights from Israel to the United States, but not from the United States to Israel, except for the crew with an empty plane. The Israeli airline, El Al, of course received insurance from its government for flights in both directions.

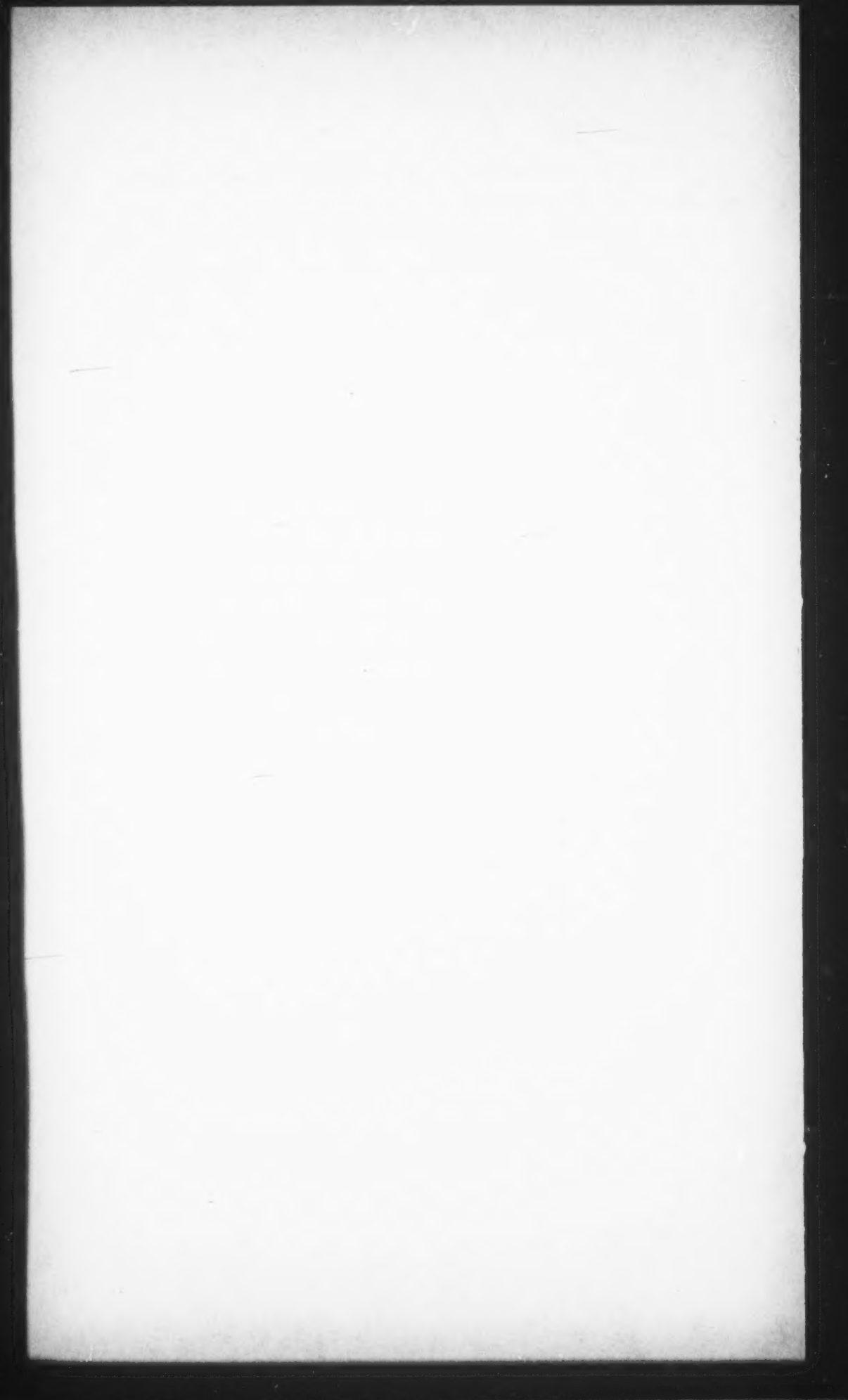
Tower Air, as a commercial matter, couldn't have operated any service under this arrangement because that would have necessitated our charging one-way passengers for the cost of operating in both directions, while El Al was continuing to charge the normal prices. What we did, however, was to link up as many commercial flights from Israel to the U.S. as we could with the U.S.-to-Saudi Arabia military charters that we were operating, and thereby keep some semblance of commercial service operating -- at least in one direction.

The result of all of this was that because of a policy decision by our government -- which, to this day, we still cannot understand -- no U.S. carrier was allowed to operate commercial service from the U.S. to our strong ally Israel, and only a few U.S.-flag carrier flights -- all by Tower Air -- could be flown from Israel to the U.S., while El Al -- our primary competitor -- continued to be allowed to operate in both directions without any

restrictions.

I don't have a legislative solution to this problem to propose to you today, except to suggest that you seek a clear answer from those responsible as to how they could possibly have reached the interpretation of Title XIII that caused the result that I have described.

Thank you very much for this opportunity to address you today.



REVIEW OF U.S. INTERNATIONAL AVIATION POLICY AND BILATERAL AGREEMENTS

THURSDAY, MARCH 21, 1991

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON AVIATION,
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:30 a.m. in room 2253, Rayburn House Office Building, Hon. James L. Oberstar (chairman of the subcommittee) presiding.

Mr. OBERSTAR. This Subcommittee on Aviation will please come to order.

This morning we continue our inquiry into international aviation policy and bilateral agreements. We have already heard from Jeff Shane, the principal policy maker for the United States on a wide range of issues under this general rubric. Today, we will take testimony from some people who have very interesting and thoughtful and productive insights into the matter of aviation policy and our bilateral agreements.

This issue of international trade has far-reaching consequences for the domestic U.S. economy. Prior to deregulation, America was principally focused on its domestic travel and had in a sense a bifurcated aviation system, with some carriers, one principally, designated for the international trade and limited in its service to the domestic carriage. And others focused principally on the domestic trade. Deregulation dramatically changed the relationship among U.S. carriers and between U.S. carriers and the rest of the world. As it turned out, those who were better prepared by having had more solidly developed domestic routes proved to be stronger competitors in the international arena.

As our international competitors surveyed the U.S. scene and envied our market and its explosive growth and tried to determine how they should shape their policies to compete with the U.S., they came up against that exploding energy of the domestic aviation market.

With the onset of Europe 1992 and beyond, the formation of a single internal market in Europe and the many policy decisions that the Europeans have to make, a new phase is on the horizon. It is with us by the end of this year in U.S.-European trade and we must be as well-prepared and as thoughtfully prepared as we possibly can be to take advantage of the opportunities and meet the growing challenge of a changing Europe, as well as be prepared to continue to develop our presence in the Pacific Rim trade.

To help us think our way through those issues we have some people who themselves have spent a great deal of time giving considerable thought and practice to the area of international aviation policy. Our first witness this morning is Mr. Daniel M. Kasper, Director of Transportation Practice for Harbridge House. Mr. Kasper has had a distinguished career with the Civil Aeronautics Board and a wide array of contributions in the field of international aviation policy, both as a practitioner of the art and as a scholar of the subject.

We greatly appreciate your contribution and welcome you to the subcommittee hearing.

**TESTIMONY OF DANIEL M. KASPER, DIRECTOR OF
TRANSPORTATION PRACTICE, HARBRIDGE HOUSE, INC.**

Mr. KASPER. Thank you, Mr. Chairman. I appreciate the opportunity to appear here and I would note that I feel in talking to the Chairman about the subject of Europe, it is unusual to find a chairman as erudite about a particular subject. I've been impressed with your comments in the past and as I learned in the last set of hearings why you know so much about Europe. So what I have to say about Europe I say with all due deference to the Chairman's expertise in the area.

As you indicated, Mr. Chairman, I am here at the invitation of the committee. I should stress that I appear here on my own behalf and the views that I state here are my own and do not represent the views of Harbridge House or any other entity. I should note, Mr. Chairman, if I could for the record, that my written testimony, which has been provided to the committee, really is a paper that I prepared for the American Enterprise Institute for a conference that was held last year. The conference was entitled, "The United States and Europe in the 1990s." This paper has been revised as of January of this year and is going to be forthcoming in a volume published by the American Enterprise Institute. That's noted in there so I have attached that here, and that is the basis of my testimony today.

Let me, if I might, briefly summarize the thrust of the testimony and paper. I think it is important to make clear at the outset that I believe there are three major developments that have been working through the international aviation system and whose shape is now I believe clear beyond serious dispute.

The first of these is that the underlying economics of the modern airline operations, in particular the large economies of scale and scope, mean that the structure of the world airline industry is likely over the next decade to be made up of a relatively small number of large global airlines. There will be some smaller niche players around the edges, but I think we are going to see fewer and larger carriers.

Secondly, the combination of globalization of the industry and the drive toward the integration of the European Common Market are, for reasons that I will elaborate on in a moment, bringing to a relatively quick end the bilateral air services regime that has governed the international airline industry since 1945.

The third point that I would like to make is that what we are now seeing are really the initial stages of a struggle to shape what the new regime will look like. That struggle is particularly apparent, and I believe will become more so over the next year or two, between the U.S. and the European Community.

As you indicated in your opening remarks, Mr. Chairman, the advent of deregulation had a dramatic impact both on the structure of the U.S. industry and its ability to compete with foreign air carriers, particularly for traffic to and from the United States. The most important thing it did, and I know this has been the subject of other hearings so I won't elaborate on it, but it has allowed U.S. carriers to build huge domestic networks to access effectively and very competitively traffic from a whole host of points, large and small, and to put that traffic through hubs and to combine those traffic flows in a way that gave the U.S. carriers very effective and very economic access to the entire U.S. market.

In this respect, it strengthened U.S. carriers in competition against foreign carriers because foreign carriers, for example, discovered that even though they could get additional gateways to the United States, many of these gateways, after you got through the first dozen or so, were simply too small to sustain viable service.

Also, deregulation and the result of being able to expand their networks made international air services increasingly important for U.S. airlines. And I think the evidence of that is very clear today as we see the carriers, such as United and American, which as recently as 10 years ago held no international authority to speak of, have now become two of our major U.S. international carriers.

Finally, the last result I would like to mention of the deregulation in the U.S. is that it has forced foreign governments to review their own aviation policies, domestic and international, in an attempt to let their carriers enjoy or replicate the benefits of U.S. deregulation for U.S. carriers. This has led many to deregulate their domestic markets and to liberalize their international markets.

The U.S. aviation policy that was adopted starting in the late 1970s, called "The Competitive International Aviation Policy," basically attempted to trade access to the U.S. market for liberalization of air service regimes with other countries on a bilateral basis. This liberalization took several forms; typically, it included an expansion in the number of points within the foreign country the U.S. carriers could serve, and it also included typically liberalized pricing and capacity regimes so that more U.S. carriers could serve the market with more capacity and with freedom to use price as a competitive weapon. Although it may be hard to recall when at 8:00 this morning British Airways announced a major price reduction across the North Atlantic, if you go back not more than about 15 years, you had the United States Government and the United Kingdom Government taking turns rejecting low fares across the transatlantic out of concern that they protect their carriers from competition. So the pricing freedom has been a major element of it.

The problem, however, that the bilateral negotiations ran up against is that when foreign carriers discovered they were unable to serve the U.S. market out of more than a few gateways and the U.S. carriers with their large networks were able to draw traffic from the whole country, the pressure began to mount for more ef-

fective access to the internal U.S. market. So we started seeing things like requests for coach-sharing agreements. You started hearing for the first time requests for things like cabotage. And, more lately, requests, and in some cases approaching demands, in the area of foreign investment—the right to invest.

The problem with all of that—well, there are a number of problems with that from a negotiating point of view. One, obviously, is when we look out from the United States abroad and say—let's suppose that we were inclined to think about access to internal markets—if a U.S. carrier could establish operations in France and the French carrier could establish operations here, what would each side get in return. The answer is what we would get in return is access to a very geographically small market, one in which the regulatory system that's in place, which is a tightly regulated system, would not permit our carriers to come in and do the kinds of things they did in the U.S. domestic market to get traffic. In contrast, the French carrier would have open access to the U.S. market with the assurance that it could come in, set up operations, compete freely in terms of price, put its routes wherever it chose, and so forth. So you had a combined problem really of market size and regulatory structure.

When you look at the U.S. and the European Community, however, a different picture starts to emerge. First of all, the EC is more or less equivalent to the U.S. in terms of market size, population, size of the economy. As an air travel market, it is a rough equivalent to the U.S. market. Interestingly enough, under the European Community governing legislation, the retention of bilateral air services agreements really depends upon and it only can exist so long as there is no European Community common air transport policy.

When you look at the actions that the Community has taken over the last year, however, it is quite clear that the Community has in place all of the basic elements of a Community air transport policy. Therefore, I think it is highly likely that the Community will increasingly assert its jurisdiction over air services of member nations with third party states, including the United States. Let me just briefly mention, the committee may be aware, the second package of measure that the Community has been considering for adoption.

One is that it explicitly recognizes that the implications of the common internal market for the external air service agreements currently existing in a bilateral basis between the EC member states and third party states, including the United States. So they have noted that there is a link and they have gone out of their way to talk about the need for reciprocity and, in some cases, their views that there is insufficient reciprocity in that U.S. carriers enjoy Fifth Freedom Rights. They are starting to refer to those as internal or EC cabotage rights within the EC, whereas European carriers do not enjoy cabotage or internal rights within the United States. So they have flagged it as an issue.

Secondly, in the area of fares, in a case decided several years ago, a case that I cite in the paper, the Ahmed Saeed case, the European Court explicitly made clear that the Commission has authority over external fares. This is a very important issue. The

reason it is very important is because one of the most important things that the United States has been negotiating with European Community states as well as other countries over the last decade has been pricing articles that give our carriers and, indeed, theirs the right to compete freely in the area of price. If the Community now is to come back and to assert an overriding jurisdiction over fares on the basis of the Community's legislation, and that is very likely then to impair or to threaten to impair the pricing agreements in the U.S. bilaterals, I think the United States would very rightly, and I trust vigorously, object to that and demand concessions if, indeed, there were any attempts made to change that. In short, I think we're likely to see a bumping of heads fairly soon in this area because the Community is starting to exert its jurisdiction there.

Third, there is a definition of a Community airline contained in the second package which permits some countries—let me back up. The definition of a Community airline contained in the second package makes it possible for airlines that are effectively controlled by some non-nationals of EC member states to own controlling interest in an airline that would retain its rights as a Community airline. But these are grandfathered and no further right to do that exists. So that you have the situation where some countries actually can control a Community airline but others can't. That sets up a potential for some discrimination. It hasn't been actively raised yet, but I think as interest in trans-border investment starts to increase in Europe as well, this is likely to become an issue.

And finally, and I think the one that is most likely to lead fairly directly to conflicts with the United States, is a very quiet directive the Community has had out to its member states for a little over a year now which requests them to bring their citizenship and control provisions of their bilateral agreements into "conformance with Community policy." Well, the citizenship and control provisions simply mirror those contained in the U.S. and, indeed, in every bilateral agreement I have ever seen, which says that the party that designates an airline assures the other party that the airline or airlines that it designates are owned and effectively controlled by nationals of the designating state. In other words, when we designate an airline to serve a European country, we are assuring them that that airline is owned and effectively controlled by citizens of the United States. They have similar obligations to us.

The European Community, however, for internal purposes obviously, wants to have this provision eliminated because it doesn't make sense to say that it is a Community if Air France isn't entitled to the same rights as Lufthansa in Germany. That part is unsurprising. What they have further said is now let's bring these provisions into conformance externally. In other words, we want you to change your bilateral agreements with the United States so as to permit Air France to serve from the United Kingdom and not be in violation of the citizenship and control provisions. I think in light of the recent U.K. agreement this effort by the Community is taking on a more apparent importance.

Finally, let me close by giving you a brief summary of what I think to be the European Community strategy, and I use the term advisedly. I'm not suggesting that this is a master plan, but more of a broad brush economic strategy that the Community has been following and what I think its implications are for the U.S. As I see it, the Commission now has in place at least the rudiments of a strategy for dealing with the United States in the air transport sector. That strategy can be summarized as follows.

First, force a rationalization of the European airline industry by increasing the level of internal competition. Try, in other words, to get some of the stronger carriers to emerge much the way stronger carriers have emerged in the U.S.

Second, to negotiate first with non-EC nations to create a Europe-wide aviation market and possibly a larger bloc for negotiating with the United States. They have already made clear in the Community that their first priority for negotiations is with the European Free Trade Association, or EFTA. That's the first order of business. And they are going to use those, I believe, in addition to develop the Commission's own internal expertise and to develop mechanisms for tapping the aviation expertise that the bilateral negotiators in the member states have. One of the biggest disputes internally right now, as you might imagine, is some of the member state aviation authorities don't like the idea of a Federal EC coming in and taking over. I have been at several sessions where I suggest that this is going to happen and it makes the bilateral negotiators very unhappy. But it is I think happening nonetheless.

Finally, I think the European strategy would be to convert the EC and, if possible, European routes into internal cabotage routes and to exchange those for additional traffic rights in negotiations with the United States and probably Asia as well. And finally to use leverage from a common European front in trying to aggregate the 12 or perhaps the 20, or some lesser number but more than the EC, to obtain leverage from the United States and/or to restrict U.S. access within Europe if they can't get what they are looking for.

Under these circumstances, I think it would be a mistake for the United States to wait for Europe to push the events in our direction. The Europeans are undergoing simultaneously an attempt to bring their internal aviation policies into a more competitive posture to open up competition. Frankly, I think if we wait for them to do that, there are inevitably going to be many difficult trade-offs in that process. And having just gone through the process of making those trade-offs to satisfy each other, then to expect them to turn around and negotiate with the United States with those wounds still open, so to speak, and to negotiate an agreement with the United States I think is unrealistic and I think it would be unwise. What I am very concerned about, frankly, is that I think if we push now, we would be in a much better position to ensure a more liberal regime in Europe; and if we don't, we are likely in my view to be faced with another European Community CAP—in this case, not the Common Agricultural Policy, but something equally odious, a Common Aviation Policy. It will be particularly sad if that happens because I think we could have done something to help avoid it.

The last point I would like to make is that I think the events, both economic and political, that have taken place in the world over the last few months have started to increase the pressure even more, and that if the Community and the United States are not prepared to start engaging in these negotiations fairly quickly, events are likely to move a little faster and force something to happen anyway. I am thinking specifically here of the impact of the war in the Gulf, fuel price increase, and the recession, which is putting not only U.S. carriers but also European carriers under extreme financial pressure. Since this committee last met, or at least within the last couple of weeks, Air Europe, a new entrant European carrier, has gone into bankruptcy and appears likely to go out of business. Virtually every other major European carrier has gone through a very substantial economic downsizing, lay-offs, cutbacks, a variety of things.

I think as things stand now, both the U.S. and the European Community have an interest in exploring some common ways in which they might be able to preserve and strengthen competition. And I think the primary one of these would be in the area of trans-border investment. If Europeans were entitled to invest in U.S. carriers, and visa versa, I think that both sides would stand a much better chance of preserving and strengthening competition and preserving jobs in both countries than if we both decide that we only want U.S. citizens to participate in the U.S. airline industry, and only European citizens to participate in the European airline industry.

In order to get there, it is going to require fairly significant changes, both in terms of how negotiations are organized and what is included. The "How" basically looks at multilateral negotiations rather than bilateral negotiations. And the "What" means that the subjects on the table are going to have to include things like investment, the right of establishment, ownership, and elimination of governmental subsidies. I think the U.S. and the EC are far and away the most likely starting point for these negotiations for a whole variety of reasons that I think I don't need to elaborate for this committee. And I think the recent U.S.-U.K. agreement may in some respects, particularly with the advent of the rights for a British carrier to serve from the continent, actually provide the opportunity for a first step in this area.

Thank you very much, Mr. Chairman.

Mr. OBERSTAR. Thank you very much, Mr. Kasper. Your document is a very comprehensive and very thoughtful piece. It shows the product of considerable study and sharp insight into the issues before the committee and particularly those facing aviation in the United States in the international arena.

I note in your opening remarks that you have a number of clients. You reference U.S. airlines, airframe manufacturers, and suppliers of goods and services, as well as airport proprietors. Could you identify some of those corporate clients?

Mr. KASPER. Going back to about maybe January of 1989, the airline clients have included American, Continental, Eastern, and Delta. Airframe manufacturers have included Boeing, I have worked for the Port of Seattle, on the airport proprietor side, I have also done some studies for the New York Port Authority.

Mr. OBERSTAR. Good clients. People who have obviously taken advantage of your sound advice.

Mr. KASPER. Not enough, Mr. Chairman. [Laughter.]

Mr. OBERSTAR. Well, I must say that three years ago I talked to a number of those very same entities about the emergence of post-1992 Europe and they looked at me as though they were a little puzzled; maybe this fellow has really gone off his rocker. It reminded me of coming home my first year in Congress to talk to an economic development group about the changed scene internationally and nationally and that the time had come to look to a new future for Minnesota's iron ore mining country, that we ought not to be so complacent and reliant upon the taconite industry, and ought to do a number of other things that I suggested. One of my good friends, the president of the Mountain Iron Chamber of Commerce put his arm around my shoulder afterward and said, "Jim, that was a very nice and thoughtful talk but I think you've been out east too long already." That was after about two months. [Laughter.]

I think that's the way a good many of the big players in the U.S. aviation industry looked upon Europe, that puzzling entity across the pond and they don't understand what we're all about and the carriers weren't interested in trade. They are now beginning to understand the significance of that market.

What I think is one of the most important contributions in your testimony is your comment that a strategy of waiting would be a mistake. You suggest, as an offensive move or preemptive strike on the part of the U.S., to develop on a smaller scale with a smaller number of entities a liberalized scheme. I said as much about two years ago that I thought that we ought not to wait for Europe to consolidate; that we ought to force the process ourselves. Since Europe was internally disorganized—and a good many of my classmates in the College of Europe are now in their respective governments as very key people or policy-makers within the European Economic Community and with whom I maintain regular contact—they were having a very hard time, and still are having a very hard time, rationalizing their own policies internally and charting a direction for themselves.

It seemed to me the best strategy is to help them do that; force their hand in a way that benefits us. Put them on the regime where we do the best and that is not by having some protection, not by protecting some markets of our own, but by forcing them to open theirs. After all, it was Europe that invented the cartel and Europe that knows how to massage it the best. We ought to break those open. So liberalizing our investment regime in such a way that makes it so attractive that they cannot refuse to liberalize and open their own internal regime, but not to give away too much also.

I told a meeting of European airport authorities about a year and a half ago that they have to modernize their air traffic control system. If I were a U.S. carrier and advising U.S. carriers, I would say what incentive is there for a U.S. carrier to go into Europe with one-fourth the airspace of the United States, twice as many air traffic control centers, fewer controllers, and antiquated equipment that predates some of the old Civil Aviation Authority of the United States, where aircraft are handed off by telephone and not

by computer. What advantage is there to the United States in a country one-fourth our size, if you take all of Europe together, that has 100 million hours of delay. So you have to get your own internal act together if you expect us to open our modern, efficient, effective, and progressive regime to your carriers.

So let me ask you to expand on that theme. Investment would be one opportunity, one incentive, liberalizing it on both sides. Obviously, we want them to liberalize their fares and we want them to liberalize market entry. What other things?

Mr. KASPER. Well, I think you've hit the major ones. And I would include with the investment, Mr. Chairman, the right to establish, I think, which would simply say that investment could mean coming in and buying an interest in an existing airline. I think the right to establish, which is to say to come in and set up an airline under laws of the Community or under the laws of the United States—

Mr. OBERSTAR. That would mean enticing or in some way requiring the Community to drop that rather offensive language that you referred to in your testimony that the smaller European carriers lose their European character if acquired by a non-Community interest.

Mr. KASPER. That's correct. That would have to be on the table and reciprocally, I am sure, the Europeans would say we would have to put the Federal Aviation Act's 25 percent requirement on the table as well. But you make a good point, Mr. Chairman, that I would like to emphasize, which is that there is still a tendency even today to try to separate aviation markets into domestic and international, to separate out the questions of effective access that get tied up in things like air traffic control. I think if we've learned anything over the last ten years it should be that while in the old days it may have made great sense to think about international and domestic and the twain only met at the gateways to hand off passengers, that is simply no longer the case.

And if we wait and do not put these issues on the table with the Community, there frankly are carriers and governments in the Community that are not as interested as other governments in trying to set up a more liberal internal regime, and if we don't interject ourselves in that by saying what you do internally affects and is related to what you do externally, then it is going to be much more difficult for us to negotiate the kind of a regime that makes sense for U.S. carriers and U.S. citizens as well as European carriers and citizens later. Because some of the more protectionist carriers within Europe, a number of whom happen to be affiliated with governments that are influential in the Community, will make it very difficult to do that.

It is a fluid situation now. It is becoming less so, certainly a lot less fluid than it was two years ago. But I think the opportunity is still there if we are prepared to take it. To a certain extent we have done a little bit of an Alphonse and Gaston routine with the EC, the Commission—well you ask us; well, no we can't; we need to talk bilaterally, but the Commission says we can't approach you because we've got these political problems back in the Community but if you approach us we can talk. Nobody has pushed it. I think if we don't, the ground in Europe—I don't know whether there is

going to be a Maginot line or a set of Iranian defenses along the border—but I think it is going to be a lot harder and we're going to have to deal with something that is much more fixed if we don't get in and start negotiating. And I agree, one of the things that ought to be in there is at least some indirect link to air traffic because that makes effective access, which is what we are really talking about, and that's a very important part of that.

Mr. OBERSTAR. Yes. I would just carve out of Europe one or two target countries and begin aggressively to build on the recent modification of the U.S.-U.K. bilateral and renegotiate it from top to bottom or attempt with Air France or Lufthansa. I think there are any number of those who would be eager to be the first one to negotiate the most liberal regime with the United States, be the first ones to plant their flag on our soil and get into our market place; and the first ones that would have to agree to substantial broadening and liberalization.

I will have a number of other questions later, but I want to proceed with other members.

The Chair recognizes Mr. Hobson.

Mr. HOBSON. Thank you, Mr. Chairman.

I just have a couple of questions. It was very interesting testimony. Do you think, based upon what you said, that we should not restrict now investment by foreign interests into say domestic airlines until we begin this negotiation that you are talking about?

Mr. KASPER. I think, no, I don't. I think under existing law the United States can, and has to date at least, fairly effectively controlled foreign investment. So I think with the 25 percent restriction, even with the liberalization recently announced by Secretary Skinner, I do think we have more than sufficient ability to control the investment. What I think is lacking is in that modification of policy.

I would prefer to see the benefits of further investment rights being tied explicitly to the willingness of the countries involved to sign "Open Skies" agreements with us. In other words, if we are going to start building this regime, then let's say investment is so separate that it can be dealt with separately. I think we can control that now. What is lacking is the other part of the architecture, which says in order to get more you've got to give us more.

Mr. HOBSON. If you were negotiating, and there are routes available or gates available overseas, do you favor going with these existing carriers into that area and letting them expand or putting new domestic carriers in there? How would you do that?

Mr. KASPER. Well, when the Open Skies policy got started, the idea was let's see if we can open up—we don't know, or didn't know at the time at least, who were going to be the likely winners to emerge from the U.S. domestic competition. So rather than get the Government in the business of picking carriers, the objective of these Open Skies agreements was, and I think to the extent we can get it still should be, to open up the market so that any carrier could enter the market. So you don't have to go through a government certification process to do that to the extent you could get those kinds of agreements. And I think we've got some leverage we just haven't used, such as investment, to do that. You don't have to get into the question of which carriers should be selected. If we are

unable as a Nation to negotiate that kind of access, then we end up in a situation where we have to pick which carrier is the best. That's a very difficult undertaking.

Having sat on the other side of that process for several years at the Civil Aeronautics Board, I can say that you can usually eliminate a couple of carriers that are unlikely to be able to succeed, sort of consensus judgement; picking between the remaining three or four or six is like throwing darts. Even sorting out the initial sort is dicey. The question is, would Freddie Laker have been in there. Well, you can argue he probably wouldn't have been, and his subsequent behavior showed he shouldn't have been—you know, he didn't succeed. But that's a very arbitrary business.

It is a balancing between what's trying to do what is best for the United States and the travelling public by using the limited rights, putting them in the hands of carriers that can use them most effectively, and making sure in doing that that it doesn't always mean that that's the strongest carrier or those are the strongest carriers that get the rights.

Mr. HOBSON. My last question, this is probably a comment rather than a question, but I would like you to comment on my comment. If I view your scheme overall, in looking at this I sense hubs here that are a continuation in the domestic and foreign arena. In other words, fly Columbus to Europe on one continuous airline and that would be out of a hub. As someone who flies out of a place that doesn't have a lot of competition that is a hub, what worries me is when that configuration comes about, I can tell you today I don't have much choice and I pay a fortune in my opinion, even the Federal Government rate, to get here versus if I go 50 miles east of me and get on an airline where there is some competition. You have a much better price break if you want to go anywhere, even here.

So that's what worries me about the hub. A hub tends to give a dominance to whoever established the hub in that area. Everybody else leaves and then prices—you don't have any ability to do any kind of competitive pricing. Do you see that happening or will they have common hubs?

Mr. KASPER. I think that the number of hubs—you are probably not going to find too many more overlapping hubs because I think we've seen that there are very few places even in the United States—you know, some of the larger places like Chicago, which sustains two hubs; Dallas, which sustains two or, if you count Southwest, even three, although Southwest isn't exactly a hubbing carrier—but not very many of those places around and one hub looks much more like the norm. There is no doubt there is some trade-off for the citizens of the community—

Mr. HOBSON. Well, that's who they are supposed to serve.

Mr. KASPER. But it is not all a negative trade-off. For example, let me just pick St. Louis. St. Louis gets more service than it would as a non-hub airport, or at least historically has. On the other hand, there is no doubt that carriers do charge somewhat of a premium in many cases for nonstop service. There are alternatives, even in the case of St. Louis. If you are willing to go through an intermediate hub, there are typically more favorable fares there. But it is a trade-off. The hub gets jobs, economic development,

growth, and more flights, and the price for that may be a somewhat higher price for the nonstop service.

Mr. HOBSON. Thank you.

Mr. OBERSTAR. The gentlemen from Illinois, Mr. Lipinski.

Mr. LIPINSKI. Thank you, Mr. Chairman.

Mr. KASPER, this cabotage that we hear about. Correct me if I'm wrong, cabotage would be if Lufthansa was permitted to come to this country and fly between Chicago and Washington, DC. It is a second nation national flying entirely within the boundaries of another country; is that correct?

Mr. KASPER. That is close. This is an area that the discussion in my view is very, very confused. Let me make a distinction.

Mr. LIPINSKI. I'm glad to hear you say that.

Mr. KASPER. Let me make a distinction here because I think in many respects there is a big brouhaha over the cabotage and it may be, to quote someone else, "much ado about nothing." Cabotage is when Lufthansa flies on an international flight from Frankfurt to New York, and then that flight continues from say New York to Washington and carries domestic U.S. traffic—that is, somebody gets on Lufthansa's plane in New York just to go to Washington; the U.S. citizen has not flown on Lufthansa from Germany, nor flown over earlier and is stopping over. So you take the foreign aircraft, you continue it as part of an international flight to another point. That is cabotage.

It would not be cabotage if Lufthansa had the right to establish here because then it would have to hire U.S. citizens, be a licensed U.S. airline, use U.S. pilots, flight attendants, mechanics. If it flew from Frankfurt to New York with a German crew, then if it wanted to fly from New York to Kansas City, Lufthansa USA would do it but that would be a U.S. carrier staffed by U.S. citizens, et cetera.

Mr. LIPINSKI. Would it be so?

Mr. KASPER. It would have to be.

Mr. LIPINSKI. It would have to be.

Mr. KASPER. Nothing we're talking about—nothing I'm talking about, certainly, would change U.S. labor laws or U.S. immigration laws.

Mr. LIPINSKI. The definition though of cabotage, I really thought—and it comes from an old mariner term—and it was where say the United States would have a ship and it would go to Italy and the ship would pick up something in Rome and take it up to Naples and then it would take it up to Florence. That's where it came from. From what I understand, that would simply be——

Mr. KASPER. That's correct.

Mr. LIPINSKI. That would simply be a second nation operating totally within another nation. So, is cabotage, as it is being applied to the airline industry at the present time, it is not really a direct descendent of the mariner cabotage.

Mr. KASPER. I mean, technically, if it is used accurately, it should be because the example we used of Lufthansa flying with the German crew in a German plane to New York and then to Washington would be the equivalent of a U.S. merchant vessel going to Rome from New York, picking up cargo in Rome and carrying it to Naples. It is an exact equivalent.

Mr. LIPINSKI. Okay. What—

Mr. KASPER. I think where the confusion comes in is where the discussion blurs the distinction between a continuation of an international operation, which has very limited potential to have competitive impact in the market, and the entirely different issue, which is erroneously referred to on occasion as cabotage, which is the establishment of a separate airline—

Mr. LIPINSKI. Flying within the United States.

Mr. KASPER. Right.

Mr. LIPINSKI. That's not what cabotage is?

Mr. KASPER. That is not what cabotage is.

Mr. LIPINSKI. You talked about the population of the European Community being approximately the same as the United States, which I believe is true. But is the traffic that goes on in Europe any where near the traffic that goes on in this country?

Mr. KASPER. If you look only at the scheduled traffic, the answer is, no. However, Europe, because in my view largely the way they have regulated the market, they have a very large charter sector. What I mean when I say the way they have regulated the market, it is a very strictly regulated high price service on scheduled service cartels. The leisure travel, the vacation market is done by charter. That's a very, very large market. It is approximate the same size as the scheduled service market.

Mr. LIPINSKI. If you take the charter and the regular commercial market, put those together, how does that compare to the domestic market here?

Mr. KASPER. Well, they are comparable markets. I don't remember the specific numbers, but the European Community is larger in terms of population, the average stage is—it depends on what your measure is, I should say. The average stage length in Europe is obviously shorter. So if you do it on RPMs, Revenue Passenger Miles, you will get a somewhat different measure. But if you look at it in terms of passengers, it is a much—

Mr. LIPINSKI. Well, I guess my question is leading into is it advantageous or would it be advantageous for American carriers to go to Europe and fly from Frankfurt to Rome—would it be advantageous for the American carriers and for the United States as a whole to have this happen and have Lufthansa come here and British Airways, et cetera, come here and fly from Los Angeles to Chicago, Chicago to New York, New York to Atlanta? In your opinion, is this going to be advantageous to us?

Mr. KASPER. I think the answer is, yes, that it is likely to be. I think it is clear to me at least, based on my conversations with U.S. airline industry people, that there is no urgent interest in getting into Europe and establishing domestic operations within Europe. But the reason is that I think most feel, accurately I suspect, that the next couple of years, as Europe goes through its own shakeout as a result of its internal liberalization, is going to mean a market that is not going to be terribly attractive for a while.

I think it more likely, since the European air service market is well developed, as indeed is the United States, you would be more likely to see a U.S. carrier perhaps purchasing a controlling interest in an existing European carrier and using say a Sabena or a KLM as a vehicle for building that. And by the same token, I think

at least some of the European carriers might be much more interested in buying a controlling interest in an existing U.S. carrier. And there are a couple that could use the help, frankly, managerially and financially.

Mr. LIPINSKI. You were talking about allowing investments of foreign airlines in American airlines. Just prior to that though you were talking about what bad shape all airlines, generally speaking, are in. You talked about this cross-border investment. I don't know where we're going to get the money. If the European airlines are in trouble and many of the American airlines are in trouble, I don't know where we're going to get all this money to keep all these airlines afloat, even if you bring it in from foreign countries.

Mr. KASPER. Good question. And I guess in an earlier session the committee attempted to look a little bit behind the current financial situation, and I won't repeat that, but basically what I see when I try to look to the current crisis is that you have a small number of airlines in this country who are financially, managerially, and operationally very well postured. These are carriers that are clearly going to do well and as the economy picks up and traffic starts to grow again, they will do even better. You have a similar situation in Europe that all the animals are equal but some are more equal. There are some more equal animals over there, too.

So I think that what you are likely to see is that some of them have very strong balance sheets, they are viewed as good credit risks, and I think the financial markets are prepared to see that there are some advantages that can be gained by linking carriers across borders, and that therefore the capital markets would be open to these carriers to do that. It won't be open to all carriers. The idea is if we manage it properly, what we will be able to do is to match up some of the carriers that are going to have a difficult time surviving here with some of the carriers that are likely to be survivors from Europe or Asia, and vice versa, and the end result is we will have more competition both here and there, more jobs, more airlines.

Mr. LIPINSKI. I wonder about that, but I am sure my time is up. I thank you very much. Thank you, Mr. Chairman.

Mr. OBERSTAR. The gentleman from New York, Mr. Boehlert.

Mr. BOEHLERT. Thank you, Mr. Chairman.

How many domestic airlines would meet your criteria for success, that is financially, operationally, and managerially successful?

Mr. KASPER. I would say right now there are four that would quite clearly meet it, a fifth I think is very well positioned to do it, and a sixth that has got some potential but isn't there yet.

Mr. BOEHLERT. Secretary Skinner testified a couple of weeks ago that he foresees in the next 12 to 24 months a diminution down to 3 to 7 airlines. Do you share that assessment?

Mr. KASPER. I think that—the timetable I think is not—I am not sure 24 months is right, but I think I would share the view that over the next several years, maybe as long as 5, what we are going to be looking at is a set of somewhere between 3 and 6 or 7 large network carriers. You will probably have several carriers that have been traditionally described as niche carriers around the edges of that.

Mr. BOEHLERT. As we're looking to evaluate the request for international routes, would you think that financial viability of the airlines should be a prime criterion and judged in awarding a route? It's a crap shoot at best; it's like shooting darts, you said I think. What should be the determining factors as we look? Under the present system, and I know you don't like the present system, but as we are looking to determine who is going to get the prize, what should be the key criteria?

Mr. KASPER. My own preferred criterion I think would be that the carrier should be picked that would provide the most competitive benefit in the marketplace. And I say that because I really think we should keep in mind that the ultimate purpose of any aviation policy should be to serve the consumer.

Mr. BOEHLERT. Well, if we're looking at Baltimore-London, Philadelphia-London, I think several would qualify as contributing to competition. But how would you more narrowly define who should get the pluses?

Mr. KASPER. I do believe, to specifically answer your question, that financial strength and viability should be a consideration because if you put in a carrier that lacks financial strength, that carrier—and we've seen it; Pan Am testified at length that it lacked the financial strength to compete in the Pacific division and that's why it had to sell it—

Mr. BOEHLERT. Let me ask you that. We're both agreed with Secretary Skinner that we're talking in the neighborhood of 3 to 7 months over the next 24 to 36 months. If an airline is maybe at the margin but being awarded the route would strengthen its financial position, should that be a favorable consideration?

Mr. KASPER. I think that is a factor that has traditionally been considered a factor and one that I think is reasonable to consider.

Mr. BOEHLERT. Longer ranges, you are looking at the globalization of international aviation. Would you speculate, around the turn of the century how many of those global airlines will be U.S. based?

Mr. KASPER. Four.

Mr. BOEHLERT. Thank you. That's all, Mr. Chairman.

Mr. OBERSTAR. Thank you.

The gentleman from Illinois, Mr. Poshard.

Mr. POSHARD. Thank you, Mr. Chairman.

Mr. Kasper, help me understand this whole international agreement. Is it a given at this point in time that bilateral agreements will of necessity be dropped under a new European Community air transport policy?

Mr. KASPER. It would be overstatement in my view to say they will be dropped. I think the European Community has not quite figured out how it is going to do it. Some would argue that what is going to happen is you will in fact substitute a broad bilateral, a U.S.-EC bilateral, for a series of 12 bilaterals that currently exist.

Mr. POSHARD. But what is the likely scenario if that becomes reality? Which of the European bilateral contracts right now would most strenuously object to that?

Mr. KASPER. I think if you look at where we have the most open agreements in Europe, I think we could anticipate in some respects the least resistance there. Those would include countries like the

Netherlands, Belgium, Germany, where we have quite an open agreement although it remains to me not entirely clear how enthusiastic the Germans are about opening up further. I think the countries where we could clearly expect some resistance would be the southern European countries. I think Greece has been a real footdragger in this area, Spain has been somewhat more forthcoming but not enthusiastic, Italy has not been terribly forthcoming. So I would anticipate more of the difficulty there.

Mr. POSHARD. So in terms of what you are advocating for our long-range interests as far as our policy goes, are we in a position then where we should be picking off some of these countries on an individual basis rather than waiting for the European solidarity movement to occur in terms of air transport policy? If so, which of those should we begin negotiating with now, and how do we do that? It seems to me that if the European Community is going to develop a common air transport policy, and they are already in the mode of trying to integrate non-members into that as an even broader coalition effort, aren't we going to be at a distinct disadvantage in terms of our negotiating?

Mr. KASPER. The answer to that is, yes. I would think you could probably get Saddam Hussein to testify about the lack of attractiveness of having a coalition lined up against you. I smiled when you asked the question because as someone who formerly negotiated these agreements has been accused, and I willingly accept the accusation of Europeans that the United States played what they described as a "divide and conquer" strategy in trying to open up Europe in the late 1970's and early 1980's, I think my view is, yes. I think we can. I don't think it is a divide and conquer; I think it is an attempt to squeeze the most liberalization out of a group of nations that have mixed views about liberalization but who have an internal timetable and a set of internal forces that are pushing them to do some things internally.

Basically, we've got two choices. We can either wait for them to get their internal act together, or we can start now because there are carriers and there are countries that want to grow. I think the recent U.S.-U.K. agreement points a finger exactly in the direction of one of the countries and one of the carriers that is most interested in growing.

Mr. POSHARD. So you are advocating then that we do the latter—we start now.

Mr. KASPER. Yes.

Mr. POSHARD. We should not wait until they get their act together, so to speak. Who would the non-member countries be that they would be soliciting support from for their position now?

Mr. KASPER. I think if we waited, the European Community has already indicated it is going to hold negotiations with the European Free Trade Association, the EFTA countries. They are a very natural, logical place for them to start because in a couple of cases, a carrier like SAS, for example, has ownership in both the EC and in EFTA. Swissair, a very strong European carrier based in Switzerland, not part of the Community. If that market is going to be put together in a way that makes sense, the Europeans have to come up with some way to deal with that.

Now we can wait for them to do that; they will ultimately do it. I don't think we will like very much the way they've done it and I think it will be a lot harder for us to get the kind of a liberal agreement we want. But as I indicated in my testimony, I think a much preferred approach—I think it is going to have to be done multilaterally, and I think the way we should start is with what I call a targeted multilateral agreement, which basically is we pick a couple of countries that are important players, that have a common set of institutions, market economies, preferably privately owned airlines and say, look, let's start talking, we're going to make a deal here. And the deal is open to others if they come in on the same terms.

Mr. POSHARD. Okay. Just one other quick question, Mr. Chairman. If, as it apparently is coming true in this country and Europe as well, bigger is better in terms of economic survival, where would the most disenchantment with that be coming from within the European Community bloc? Who is likely to not benefit from that concept?

Mr. KASPER. A couple of the countries that I mentioned earlier that are resisting liberalization in Europe are resisting it primarily—well, there are a number of reasons why they're resisting it. One of the reasons they are resisting it is because they feel their airlines are not competitive and would not fare well in a more open market environment. There are others—I am going to use Sabena because it has been on the market, it has been almost bought and almost sold, and not quite a couple of times—and people who have looked at that situation say Sabena is a carrier, it has got a hub that is located in a place that could be very attractive as part of a broader network. But it appears increasingly unlikely that airline will be able to be a long-term player or survivor with a hub based in Brussels and no connections elsewhere. So that's a carrier that has got somewhat more potential say than others, but it is hard to see without some type of investment or acquisition how they get themselves into a position.

KLM has recognized this. They have gone out, they have taken a significant position in Northwest. SAS actually recognized it very early and has been madly, as I use the term advisedly, attempting to put together a much bigger network. They've not always succeeded in some of the carriers they've invested in, both here and in other parts of the world, but they did it out of a recognition I think of strategic necessity. They may not have made the right choices as to how to bring it off.

Mr. POSHARD. Thank you, sir. Thank you, Mr. Chairman.

Mr. OBERSTAR. The gentleman from Oklahoma, Mr. Inhofe.

Mr. INHOFE. No questions, Mr. Chairman.

Mr. OBERSTAR. One of the limitations, it seems to me, on U.S. carriers participating in the European market is the strong intermodalism that characterizes European transportation. The French are well underway with a high speed rail network. Europe, as EC, has adopted a Eurorail high speed rail plan, are well embarked on building 15,000 kilometers of new high speed rail, revitalizing 9,000 kilometers of existing rail to accommodate high speed traffic, and when you add up the investments of France, Spain, Switzerland, Italy, and Germany alone the last time I calculated it was in the

range of \$40 billion to \$50 billion. There is a policy to subsidize rail up to distances of 400 kilometers or less, to make judgments on distances between 400 and 1,000 kilometers and to which makes better economic sense, rail or air, and distances over 1,000 kilometers to subsidize air. That policy may change now in light of the higher speed French trains and the higher speed Maglev being developed by the Germans.

What are your thoughts about how the development of rail and now the "chunnel" affects U.S.-European air travel? It will, by the end of this decade, be possible to have breakfast in London, lunch in Paris, and dinner in Frankfurt by train on the same day.

Mr. KASPER. It is a good place to start. I would prefer to have lunch in Paris rather than in London, so I like that sequence. [Laughter.]

I think if I were to look at that from the perspective of a U.S. air carrier, the developments you speak of, I think I would not be troubled for several reasons. First of all, looking at it purely as a competitive matter and thinking that I am going to have to compete with Lufthansa and British Airways, I don't have any significant domestic or internal European operations and, therefore, as I look at it, my competitors are going to have to compete with subsidized government rail service on their domestic or internal market sectors whereas I don't have to do that. And as long the trains—it is a cargo issue, too, by the way, but let's keep it on passengers for a moment on trains—as long as I have nondiscriminatory access to the feeder services that are provided by trains, such as the German train, the Lufthansa train feeding into Frankfurt airport, as long as I can get on that with nondiscriminatory access to that I am protected on the feeder links. So I wouldn't be too concerned about that as a U.S. carrier.

I know U.S. carriers, every time they look at Europe they say, gee, do we really want to get into domestic operations there. They have got all of the air traffic problems you cited. Frankly, you are much better off in that situation because of the high level of air traffic charges and the delay and inefficiencies, you are much better off serving that kind of a market relatively infrequently with international flights and large airplanes than you are with a whole bunch of little flights because the charges for the small flights tend to be—you know, the cost of serving a small airplane is the same as serving a large airplane in air traffic sense.

I think on the whole I wouldn't be too troubled by that. I would just want to make sure I was positioned so that if there were any feed traffic coming in that it didn't all end up at the Air France terminal and they have to hike across the tarmac to get to my terminal.

Mr. OBERSTAR. Yes. I think we have an opportunity there to take advantage of the huge European government investments in high speed rail to serve our long-range strategic purposes for air carriage.

Coming back to the point of smaller European airlines and the Community decision about the nature of those carriers, I think there is a great opportunity for European carriers in the United States to acquire and develop a small regional airline, a commuter service, and expand that into a feeder service for a major European

carrier operating out of a domestic hub or hubs. There are fewer such opportunities though, realistically, for U.S. carriers to do the same in Europe. For example, the recent consolidation by Air France of UTA and AirInter. There are similar efforts in Germany by Lufthansa to swallow its small feeder operations and its acquisition of Pan Am's rights into Berlin. Those were very valuable rights and a great opportunity again for a U.S. carrier or another carrier besides Pan Am; that seems to have disappeared.

What other opportunities are there for U.S. carriers to penetrate European markets in a way that I think European strategy may want to penetrate U.S. markets by cross-investment?

Well, I think if you look there are a number of carriers. They wouldn't necessarily be the small feeder carriers, but you have got carriers like Sabena, like TAP, Alitalia is a sizable airline but one that is going to need—

Mr. OBERSTAR. What about acquiring one of the charter operations that are, as you said, prevalent in Europe and are a significant means of carriage of revenue passengers?

Mr. KASPER. That is certainly a possibility. I personally would have reservations about that simply because I think if the European market opens up, or, perhaps more optimistically, when it opens up, I think you are likely to see very similar results as you did in this country's market. Our charters were never as large as those in Europe, but what did become clear is that for most types of services, if scheduled carriers are free to compete in there and are not restricted against charging low fares, that scheduled service will tend to take a lot of the traffic that previously flew on charters. I know there is a great concern in Europe. They kept saying we've got these wonderful airlines called charters, and we have said if they are so wonderful why do you continue to protect them to keep them in business. And I think they are now starting to find out that the scheduled carriers will probably pick some of that up.

On the other side of that, looking at it from the U.S. side towards Europe, the U.S., as a result of history and good negotiations and the history being winning World War II, which obviously helps your negotiating position a lot, has a very extensive set of route rights in Europe. They are not perfect, they certainly could use some improvement; but we have a lot of access to Europe. So it is possible for U.S. carriers to serve a whole variety of points. We can probably serve, at a guess, 25 or 30 points in Europe from here. We can do that now, those points can sustain service. And given that surface transport network that you referred to in Europe, our carriers are able to access the European market very effectively without having a whole lot on the ground. Given the deregulation of the domestic surface transport markets in Europe, the possibility exists for U.S. passenger carriers to do what some of the cargo carriers have done, which is to link up with surface access people to feed traffic and become more competitive.

It gets a little harder when the question is what if we want to go from Europe towards Asia. Then you need to have some feed capabilities probably to feed traffic into Frankfurt from a variety of points to carry it on to Bombay or something like that.

Mr. OBERSTAR. Do you think it is going to be as difficult to deregulate fares in the European Common Market as it was to develop a Common Agricultural Policy?

Mr. KASPER. I think that the Europeans—you indicated the word earlier—they have tended to be as a group more prone to cartels and they refer to it as organized competition that we are here. I think they are getting there but basically the approach they are adopting is one the United States actually pioneered for international pricing a number of years ago which is a Fare Zone system that has zones in which pricing is free and it gets more restrictive the deeper the discounts.

We introduced those pricing articles, in fact, we did it in the late 1970's with the Philippines. The only reason we did it was because that was the best we could get; the Philippines weren't willing to go all the way so we came up with a creative alternative, a Discount Fare Zone system. The Europeans have adopted that approach. The European Civil Aviation Conference, or ECAC, and the U.S. have had negotiations which have put something like that into effect between the U.S. and Europe. They seem more inclined to do that in their domestic markets. But the objective is clearly to move to a point where it is much more open than it is now. I think that is going to be a little longer process than 1992. I don't think they are going to get there next year.

Mr. OBERSTAR. No, I think that Europe's consolidation is an evolutionary process and 1992 is not the end but the beginning of the process.

What more than U.S. carriers now have in Europe do they want or should they have?

Mr. KASPER. I am sure the U.S. carriers would have a litany of things that they would have. Trying to stand back and look at it from a public policy/public interest point of view, I think that some of the more troubling elements that I would like to see cleaned up—one of them is exemplified by what the British asked for and got—is the restriction on the ability of U.S. carriers replacing Pan Am and TWA to increase their capacity at Heathrow. There are a number of European countries, the U.K. among the more offensive of them in exercising capacity controls over U.S. carriers, restricting the ability of U.S. carriers to add frequency capacity to the market.

That is something that obviously is absolutely central and fundamental to the ability of carriers to compete and it is also critical to the ability to protect consumer interest in having reasonable prices because if you control capacity tightly enough, obviously you don't have to worry too much about controlling prices; prices will control themselves. Nobody is going to give away seats at a discount or sell seats at a discount if they can sell them at full fare because there are not enough seats to go around. So that, I think, would be high on my list.

I think unfortunately, and I say this with great regret because it complicates the negotiations, I think that we need to push very hard and consistently on the Europeans on this whole question of infrastructure air traffic control. Even referring to it as a system is stretching the point. But the system they have now is not to be believed and it imposes great burdens on the airlines and, more im-

portantly, on customers and it makes it very difficult to compete in that market even if you've got the route rights.

The third element I would add, and this may be the most difficult of all, is the question of airport access. It has probably come to the fore here recently because of the Heathrow negotiations. But it doesn't do us any good to negotiate expansive route rights if there are no slots or airports to handle it. There are some ways to deal with that besides adding capacity, which is obviously one important approach and one that Secretary Skinner is pushing very hard here. That is a very difficult negotiating issue but it is one that we I think increasingly need to look at.

In times past, we have attempted—and I would suggest we try again—to pull something out of the GATT, which is the tariff binding notion. Under the GATT, the Chairman may recall, that is a commitment that can be withdrawn. It is not like you are breaching the contract to withdraw but the party to whom the concession was granted has the right to pull back concessions.

So, for example—let me pick something out of Europe, let's pick a problem airport in Asia such as Narita—the way the system would work there is we would give the Japanese certain rights to the U.S.; in return we would get certain rights to Narita. If they are unable for whatever reason to give U.S. carriers access to Narita, then we can pull down their rights. It is kind of a “no harm, no foul” situation; we just get to take it back or they come up with something more that satisfies us elsewhere. I think we are going to have to get more creative as we get into these kinds of situations.

Mr. OBERSTAR. I fully agree. While there are many other points I would like to explore with you, I think those last three and the final comment are a good point on which to conclude your testimony. I thank you very, very much for being with us and for the time and effort you've put into preparation for today and for your long-term professional commitment to this issue.

Mr. KASPER. Thank you very much, Mr. Chairman.

[Mr. Kasper's prepared statement appears on page 320.]

Mr. OBERSTAR. Our next witness is Mr. James Landry, senior vice president for the Air Transport Association.

Mr. Landry, welcome to our hearing. Thank you for the time and effort you have invested into a very substantial statement, which I have read with great interest and which will be included in full in the committee record.

TESTIMONY OF JAMES LANDRY, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, AIR TRANSPORT ASSOCIATION OF AMERICA

Mr. LANDRY. Thank you, Mr. Chairman.

My name is Jim Landry. I am the senior vice president and general counsel of the Air Transport Association. We appreciate this opportunity to participate in your timely review of international aviation policy and bilateral agreements. We particularly commend you for setting the subject so high on your agenda in the early months of the 102d Congress, because you are implicitly reminding all of us in the aviation community that the decade of the 1990's is likely to become the watershed decade in international aviation

policy-making. We hope that the cumulative record of this and future explorations of the course our Government and our airlines should chart will fully elucidate the great challenges, the potential pitfalls, and, above all, the enormous opportunities which lie ahead.

As you know, ATA is the trade and service association of the U.S. airline industry. Our 20 operator members collectively account for over 96 percent of the revenue passenger miles that scheduled airlines operate in this country, and roughly the same percentage of the industry's freight traffic. Sixteen of those carriers provide the lion's share of U.S.-flag international air transportation service, operating to some seventy-four countries around the globe. The great bulk of that service is enabled by a sophisticated network of seventy-two bilateral air transport agreements, negotiated and refined by governmental delegations with, and sometimes against, advice from the private sector, over the past forty-five years.

In my prepared statement, which I understand will be included in the record of these hearings, I trace the history of our approach to trading international aviation rights and obligations—from the bold, visionary words of Mayor LaGuardia at Chicago 46 years ago, to the present adherence to a policy embodying guidance set forth in policy statements by the Truman and Eisenhower administrations, to wit:

Air transport rights are to be exchanged bilaterally with only the operational and technical principles being established multilaterally until such time as it is possible to achieve a multilateral agreement which contains principles generally in accord with those of existing United States bilateral agreements.

And I later suggest in my prepared statement that we are approaching a time when just such a multilateral, a regional one, may be achievable with some grouping of European nations.

On balance, from the U.S. airlines perspective, the bilateral approach has been successful. The latest DOT international air travel statistics available, reflecting passenger traffic to and from this country during the 12 month period ending with October of last year, reveal that U.S.-flag carriers garnered 52 percent of that traffic. Recognizing that U.S. citizens unfortunately have not historically shown the same propensity for "following the flag" as have nationals of other countries, a 52 percent share of a total market that was comprised of 55 percent citizens, 45 percent aliens, is, arguably, adequate, but—needless to say—one which our airlines are strongly determined to improve.

Most importantly, the traffic pie being shared has been growing at a much higher rate internationally than domestically, particularly in the last four years. That is, of course, a testimonial to the dynamic effects of the liberalization of aviation policies and laws worldwide, and the competitive capabilities of today's airlines—not merely to the improvements in our bilateral regime. But it does strongly suggest that the bilateral system is not dead, as some of the experts may tell you. Rather, we would suggest, the political and socioeconomic developments in some regions of the world make it likely, perhaps inevitable, that the sophisticated network of bilaterals which I mentioned will be complemented by one or more regional multilaterals before the end of the century, and perhaps even much sooner than that. And traffic will resume and continue

its impressive growth after the hiatus occasioned by the hostilities in the Persian Gulf. And, provided that our policy-makers and negotiators insist upon a fair balance of opportunities across the negotiating tables and a full implementation of the rights and privileges we obtain, a healthy, vigorously competitive group of U.S. flag airlines will carry an ever-growing share of that burgeoning international traffic.

From the U.S. vantage point, our 72 bilateral agreements are based on one enduring principle—a "fair and equal opportunity for the carriers of the two nations." Not an artificial division such as a 50-50 split of the market involved—the restrictive concept first adopted by a large portion of the world aviation community, but rather an opportunity for the carriers of one country to gain as much benefit from the overall exchange as the carriers of the other country. The opportunity, in short, to compete—not to hold the promotion and development of a market to the capabilities or desires of a lowest common denominator.

No system is perfect. Some of our bilateral partners have refused to rely on the marketplace to spur traffic growth, some have imposed or permitted artificial barriers to our carriers' ability to do business abroad to effectively deny us the rights we have traded for. But, on the whole, our industry has fared reasonably well. As noted previously, we continue to carry the majority of the traffic to and from our country, still the world's richest aviation market. And commercial airline services make a positive contribution to the U.S. balance of trade.

With some short-lived vacillating through the years, both our Government and we in the airlines have remained wedded to the bilateral approach, reflecting the factually sound conclusion that the United States, and in particular the U.S. airline industry, would be the losers if we were to become party to a universal multilateral accord. The soundness of this determination has never been more eloquently demonstrated than it has over the last few years, as we all considered the potential impact of including air transportation in a proposed General Agreement on Trade in Services, GATS, during the Uruguay Round.

We thank this committee, and you in particular, Mr. Chairman, for weighing in so heavily and effectively on this issue last year, and we urge you to take all steps necessary to assure our effective exclusion from any GATS agreement, in the event fast-track authority is extended for two years, as the President has requested.

Assuming that the future will not bring the tragic mistake of placing air transportation services under a GATS accord, what do recent and on-going developments realistically portend? First, as Secretary Skinner and Canadian Minister of Transport Lewis have announced, we will soon launch the effort to revamp the outdated, restrictive, and inefficient U.S.-Canada bilateral agreement. As the Secretary and Assistant Secretary Shane have since declared, everything—with the notable exception of foreign ownership—will be on the table in those discussions. The intent is to have these negotiations be the crucible for testing such concepts as open skies and cabotage rights.

To ascertain where we want these critical future negotiations to take us, it is imperative to bear in mind that the one constant is

our desire for a balance of opportunities. If, in order to achieve that in a dramatically expanded agreement, some measure of cabotage rights is necessary to balance the scales, I suspect it will come. At least, our member airlines would be prepared to consider it in an appropriate U.S.-Canada package. But it takes no crystal ball to foresee that the initial opening would be in some form of limited cabotage, that sort of fill up traffic on through routes that Mr. Kasper was referring to, and that any dose of protection for Canadian carriers for a transitional period would have to be just that—temporary and transitional. If these talks are to establish any precedent, let it not be a bad precedent.

We recognize, of course, that it will be Congress that has the final say with regard to any grant of cabotage rights in any form.

In the forefront of everyone's mind after the Canadian negotiations lies the challenges and opportunities posed by EC 1992. Once the European Community's house is in order, we will be likely to initiate negotiations for a major, expansive exchange of aviation rights. Actually, the apparent trend toward a trans-Atlantic multilateral, at least with the United States, should come as no surprise. The subcommittee should bear in mind the fact that the cornerstone of U.S. international aviation policy has always been a fair and equal opportunity for carriers on both sides to compete; a fair balancing of market opportunities. And for its part, the cornerstone general negotiating directive of the EC Commission's recommendation for the opening of negotiations between the EC and the EFTA countries was that agreements be based on the principle of a fair balance of market opportunities.

Fortunately, I might add, responsible government officials on both sides of the Atlantic—EC Commissioner of Transport Van Miert and Assistant Secretary of Transportation Shane—have asserted that operating rights held as a result of bilateral trading over the past 45 years will be maintained and provide the foundation for further multilateral expansion. That to us is a *sine qua non*. If, but only if, the rights we have obtained across many bilateral negotiating tables, sometimes at a heavy price, are honored and no one expects us to pay again for those rights, we can and will jointly build upon them. The increments can and must be added in further adherence to our common, overriding principle—a fair balance of market opportunities; a fair and unfettered opportunity to compete.

While it is not a matter that comes before this House of Congress, I do want to echo Jeff Shane's statement on Tuesday that ratification of the Montreal Protocols to update today's truly anachronistic provisions of the Warsaw Convention governing the compensation available to cover any damages or losses of international passengers and shippers should and must be a priority in these early days of this session of Congress. It is unconscionable to have families of victims waiting for years and years to receive any damages, now approaching eight years in the case of the families of victims of KAL 007. It was 15 years before the case of Pan Am's crash at Bali was finally decided by the Supreme Court last year. And we don't know how long it is going to be in the case of Pan Am 103. The package before the Senate will assure swift—six to

nine months—certain, even in the case of heat-seeking missiles or bombs, and full compensatory damages.

In conclusion, what does our crystal ball foresee happening to the intergovernmental infrastructure for the international air transportation system in the 1990's? A continued evolution in the negotiating process, producing a mixture of expansive bilateral and regional multilateral accords, rather than an abrupt and inappropriate opening of the floodgates as would be entailed by the inclusion of the air transport sector in the proposed General Agreement on Trade and Services.

We assure you that the U.S. airline industry will fully support that development, provided that the agreements do indeed promise a balance of market opportunities and thus entail no economic payment for an international political goal, and provided that no artificial barriers are constructed or retained which thwart the fair exploitation of those opportunities. We cannot over-emphasize that last point. We urge this subcommittee, in its critical oversight role, to continue to insist upon not just a paper exchange of competitive opportunities, but also a full honoring of concrete commitments to their enjoyment.

Thank you once again for the opportunity to discuss the future course of our international aviation policy with you. I will be pleased to respond to any questions you may have.

Mr. OBERSTAR. Thank you very much, Mr. Landry. You certainly give a very fine summary of the principal points and emphasize those that we wanted to cover in the course of this hearing, plus your reference to the Montreal Protocols. I said to Mr. Shane the other day, I think it is vitally important for the U.S. Senate to move to ratify the Protocol. Failure to do so will only be seen by the families of the victims of Pan Am 103 as failure and an injustice upon an already cruel injustice. Both the speed of action on claims and the increased amount of recovery, as well as a number of other important factors we need not go into here, are at stake, and I appreciate ATA's support for the Montreal Protocol. I have urged my colleagues with whom I have more than passing acquaintance in the Senate to act promptly.

Mr. LANDRY. Thank you.

Mr. OBERSTAR. You rightly point out the regime of bilaterals is not dead. I like that phrase. I fully agree. I think not only is it true, but it is important that we not bury the concept of bilaterals governing international aviation trade. I had the opportunity to point out to the American Iron and Steel Institute some weeks ago that if steel had been traded in the same way as aviation rights, we would not have seen the loss of more than a million jobs in the U.S. steel industry over the last decade-and-a-half. There would have been a way to end, or at least to thwart, the anti-competitive practices that our trading partners in steel have engaged in that proved to be the demise of so much of the domestic steel industry in the U.S.

We should not allow discriminatory and anti-competitive practices to govern international trade in aviation. The bilaterals are a very effective way of achieving that objective, whether, in the case of Europe, it is a bilateral with any one of the members of the European Commission or a bilateral with the entire unified Europe.

Now, in our exchange with the previous witness, the question of timing came up. Mr. Kasper suggested, and frankly I concur, that it is a mistake to wait until Europe has got all of its little pieces together and tells us what the regime is going to be for future negotiations with Europe. That it would be better for us to carve out a more liberalized regime with one of the European Community members and use that as the prototype for other negotiations. I would like to have your reaction to that approach.

Mr. LANDRY. Well, of course, an expansionist regime has just been carved out, if you will, with the British in the most recent U.S.-U.K. negotiations. That trade, as you well know, is receiving mixed reviews in the industry that I represent—some obviously strongly in favor of what was done or in favor of what was done, and others with some concerns about whether we gave too much.

In any event, I think that when I suggested that we should welcome this opportunity to test some very critical issues with the Canadians first, I was not suggesting that we should put off way into the distance the ultimate negotiation with some grouping of European nations. As far as the European Community itself is concerned, of course there is a lot of tugging going on as to whether the Commission is going to have exclusive competence to negotiate on behalf of the 12 member nations of the EC. There is a lot of conjecture over whether, in an ultimate European regional multilateral or bilateral, as you have described, whether it will be just those 12 nations of the EC or the European Economic Space taking in the EFTA countries as well, or perhaps even ECAC, which is even a larger group of nations with which we have had considerable negotiating experience.

I certainly agree that anything that can be done to establish expansionist accords—again, with a fair balance of opportunities for both sides—with some key nations if we can accomplish that in the interim, I think that's all to the good. I don't think this country would be ready right now to sit down and talk, for example, about cabotage. I think it is important that we go through that kind of testing and exploration first with the Canadians.

Mr. OBERSTAR. That thought tracks my view on the subject. We had the opportunity last December in the Subcommittee on Aviation to have an extensive review with Canadian aviation interests in Ottawa, meeting with every spectrum of the Canadian aviation interest, on the question of expanded trade between our two countries. My feeling being that if we can't develop a liberalized trade regime with Canada in this economic sector, then I don't know how we are going to do it with any other country.

The Canadians and the U.S. continue in almost every area to have the largest volume of traffic between our two countries and our two peoples; that forms the basis for a broadened opportunity. And here—I like your term; I've used it myself—we have an opportunity for the U.S.-Canadian trade to be a crucible, a proving ground, if you will. I hope that those talks take up some steam and move ahead on all of the thorny points, and we have to face them frankly and openly and directly and try to find ways to resolve these issues that are mutually beneficial or at least that offer mutually beneficial opportunities.

Mr. LANDRY. I hope so and I hope that the governments and the airlines on both sides of the border will look down the road to what this agreement can mean. Obviously, it comes ironically now these negotiations are opening at a time of recession and when there has been severe financial problems for carriers on both sides of the border. But we are talking about something that is going to form the framework for operations in North America for decades to come, and that's the way we ought to look at it.

Mr. OBERSTAR. I agree. If we wait until economic recovery is with us, then the opportunity for growth will have passed us because things will move too quickly.

Mr. LANDRY. The current bilateral is just so inefficient, and it is really stifling development and traffic growth, as the data demonstrate very adequately.

Mr. OBERSTAR. You certainly have done that.

Mr. Inhofe?

Mr. INHOFE. Thank you, Mr. Chairman.

Mr. Landry, I have noticed since I've been in Congress that a lot of associations have a difficult time getting a consensus and therefore have to avoid taking positions on some things that become really quite important. One such issue is foreign investment. I know that—being from Oklahoma where we preceded the rest of the Nation into a recession and hopefully will be preceding the rest of the Nation into a recovery—the need for capital infusion is very important; it is very important to many of your members of your association. I assume the ATA does not have a position as to the decision to go up 49 percent foreign equity ownership in the air carriers.

Mr. LANDRY. No. I had indicated, Mr. Inhofe, in my last appearance before this subcommittee that we hoped to be able to come to you with a precise definition of a position for some relaxation of the traditional restrictions on foreign investment in U.S. airlines. We were unable to reach a consensus of that in our discussions. So where we stand actually is that the individual carriers will continue to respond to initiatives such as the Northwest-KLM initiative that went before the Department of Transportation, and which created this change in policy allowing 49 percent equity ownership and still keeping to the statutory limit of 25 percent of voting interest. The individual carriers, at least at this time, will continue to respond to that kind of initiatives. So, I would say in the next case we will just continue to see whether precedent is going to be built that way.

Mr. INHOFE. For those members of your association who are looking for foreign capital, do they feel that it is going to be difficult to get that gap between 25 and 49 percent of equity investment or ownership without also giving them the voting ownership to go with it? Is it going to be more difficult for them to reach that?

Mr. LANDRY. Those carriers do feel that we ought to go towards that 49 percent.

Mr. INHOFE. Of course you are familiar with Mr. Clinger's bill to raise that voting ownership from 25 percent to 49 percent.

Mr. LANDRY. Yes.

Mr. INHOFE. Of those individuals who are looking for capital, more than likely it would be as an independent airline but not as an association supporting such an effort?

Mr. LANDRY. I believe that would be the case. And I think that actually there would be a consensus of all our members on at least one element of that, and that is that when any relaxation comes, in any given situation there ought to be reciprocal opportunities available, which Mr. Clinger's bill entails; and that there also ought to be, on the other side—as Mr. Skinner insisted upon in the Northwest Wings Holding decision—there ought to be on the other side a liberal bilateral or liberal regime.

Mr. INHOFE. So we could probably expect to hear from some of your members individually as opposed to your association on the legislation that is pending on this?

Mr. LANDRY. At this point in time, until, if, and when greatness is thrust upon us. [Laughter.]

Mr. INHOFE. All right. In an unrelated matter. A lot of people don't like the idea of when these valuable routes become available they go to the highest bidder, feeling that that is not enhancing competition. What are your feelings about that?

Mr. LANDRY. Again, you are exploring an area where, as spokesman for the trade association made up of some of the more successful carriers and some of the less successful carriers, you put me in an uneasy position. We do not—

Mr. INHOFE. Well, that's what we're supposed to do here. [Laughter.]

Mr. LANDRY. But I don't have a death wish yet. [Laughter.]

The one thing that I would say is that we certainly do think that the opportunity should be there for a carrier to sell its rights. It has been there down through the years in the Federal Aviation Act, and we do not object to that. Now, as to what sort of governmental intervention might be warranted under the umbrella of laws, including the antitrust laws and so forth—there are adequate protections there against tremendous abuse.

Mr. INHOFE. Thank you very much.

Mr. OBERSTAR. We have repeatedly lauded the bilateral approach as the ideal framework. But think critically for a moment, what may be some of the weaknesses in the bilateral approach? How might we improve upon it?

Mr. LANDRY. I would say that the greatest single weakness, or at least one that has been very, very pervasive down through the years, is difficulty in erasing the artificial barriers to exploiting the rights that we trade across the table, that we get across that table. There are all kinds of very sophisticated ways to block us from full implementation, full exploitation of the rights that we acquire.

Earlier this week I had the privilege of lecturing up at one of my alma maters, the McGill University Institute of International Air and Space Law, and a very perceptive student said, what you are talking about is really not a fair balance of opportunities to operate; you are talking about a fair balance of opportunities to compete. And I said, that's exactly what we're talking about because we are often allowed perhaps to operate, but rather weakly. What we need is the full opportunity to compete. I hate to use the sometimes overworked phrase of the day, but that level playing field is

all that we're asking for. Let us get out there and compete. We will do well.

Mr. OBERSTAR. That's true. And in the bilateral process we are not successful in knocking down the obstacles. Is that a matter of lack of skill in negotiation, lack of ability to be tough enough in those negotiations?

Mr. LANDRY. No. I think it is just sometimes a terribly painful and lengthy process, and sometimes these are devices—the withholding of soft rights, so to speak—are tactics or strategies engaged in by some foreign governments in order to acquire hard rights that otherwise they can't acquire because they don't have enough, as an individual sovereign nation, to give us in trade for further market opportunities in this country.

Mr. OBERSTAR. Well, there are some things that are not included in bilaterals, such as the doing business issues, a matter very important for cargo trade. We find that we often negotiate what appears to be a very good bilateral and then come back to learn that our carriers are not able to exercise the rights that we negotiated because of some issues involved in doing business with the country under those rights have blocked them from exercising them.

Mr. LANDRY. Exactly. That's true not just of cargo carriers but combination carriers as well. We had one classic case where a major U.S. carrier with the right to serve a major European nation really had totally useless counter space until we gave that nation across the table a very substantial traffic right to get that opportunity. Sometimes you can earn tremendous revenues from operations to some countries in the world and not be able to get your currency, those revenues, out in U.S. dollars or in adequate time.

Mr. OBERSTAR. One of those practitioners of the art of obfuscation of rights is Japan in aviation matters. The Japanese have continued to operate the most restrictive market in international aviation trade. Yet, you have observed the growth in international traffic is attributable to a trend toward liberalization worldwide. But I see that trend hobbling along when it comes to Japan. What do we need to do there? What are your thoughts?

Mr. LANDRY. I don't know. That has always unfortunately been the case. We have become, I think, far more prudent in withholding traffic rights, even though we've perhaps exchanged them across the table, from the Japanese when they put in artificial barriers to our operations. I believe the carriers unanimously feel that they were successful in getting the kind of slots that were needed to operate realistically at Narita Airport, which is an airport that, as you undoubtedly well know, is a monstrosity in terms of trying to really serve the demands that are in that market.

Mr. OBERSTAR. Thinking back to most recent updating of our bilateral with the U.K., which adjustments came not because of an ongoing process of updating, but because of the sale of routes by two U.S. carriers to other U.S. carriers. We found ourselves in a very difficult bargaining position with the U.K. for those acquiring carriers to exercise the rights to operate at Heathrow because of bilateral that had been in place for a long time that had some rather unusual language in it. How do we get into that predicament and how do we avoid that sort of predicament in the future?

Mr. LANDRY. I think in retrospect, and I was not involved in the 1981 negotiations when that occurred—

Mr. OBERSTAR. I wasn't chairman of this committee then, either.

Mr. LANDRY. I think it was certainly unfortunate language. I am told by those who were involved in it that it was necessary from our point of view to put in that language in order to get some traffic rights that we needed from Boston, at that point in time, to the United Kingdom. In retrospect, it certainly created some tremendous headaches for us and the British team obviously took full advantage of the situation across the negotiating table.

There are things we wish we could rewrite the history of so that wouldn't have happened, but it was there and fortunately we are going to have two very strong and aggressive competitors in the Heathrow Market. That's why British Airways doesn't particularly like the deal, along with the fact that they will also have Virgin Atlantic flying wingtip to wingtip with them.

Mr. OBERSTAR. Do you expect much foreign investment to move into U.S. carriers as a result of the Secretary's recent decision and his sort of open invitation to broader investment? There seems to be a view abroad that the market for investment by U.S. interests in U.S. air carriers has dried up or is not very active, and that in order to, as Mr. Checchi put it before this committee recently, maintain liquidity for U.S. carriers, more investment dollars are needed and the best place to get those is from foreign sources. Well, we've seen the European carriers experience the same financial problems resulting from the war in the Gulf—recession, high price of fuel, decline of traffic because of safety and security considerations. What is the likelihood of European carriers who are now being bailed out by their governments having large amounts of ready cash to infuse into U.S. carriers?

Mr. LANDRY. I think the prospects in the short-term are probably not too great and whether eventually some of those carriers will insist that we've got to have a change in the law to increase the voting interest ceiling, that also remains to be seen. I think some would want to see that changed. Others may very well, in perhaps the medium term, see the opportunities through equity investments and marketing arrangements that can flow out of the new closeness—without getting into decisions on the competition that might ensue between the carriers—marketing opportunities may lie there that would make it attractive for them as another way to penetrate more effectively the U.S. market.

Mr. OBERSTAR. Well, I think we're in for a difficult time if we expect European interests or their carriers to come to the rescue of the U.S. aviation industry. I think they are more likely to come with the intention of attending a feast for their own purposes rather than a festival celebrating U.S. carriers.

You are concerned about multilateral negotiations. What is your estimate of how soon the Europeans are going to resolve some of their internal problems, difficulties, among their member nations about the internal market, and when do you think we ought to begin a more aggressive negotiating effort with either individual member states or the EC collectively?

Mr. LANDRY. I think we can continue to look aggressively for expansionist opportunities with bilateral partners in this interim

period. I think there is a very major issue, as you well know, over the competence, the authority of the Commission to negotiate on behalf of those 12 countries. In fact, one of their officials once suggested to me not too long ago that they might very well have to resolve that in the European Court of Justice as to whether they did have competence under the Treaty of Rome. So it may take a little while for them to be in a position to collectively deal with us.

I do think though, again to repeat what I said before, that we ought to use this breathing space however long it is, perhaps a year, to really negotiate, test all those critical issues with the Canadians and see how far we can expand. Then that will be a prelude to negotiations that I would think could occur as early as the fall of next year, 1992, or 1993. I think European officials think quietly, not publicly, of negotiating in 1993, perhaps with the U.S. rather than immediately because they are shackled right now, they don't have the authority.

Mr. OBERSTAR. They sure haven't and they have many problems of their own to resolve. I just like the idea of being on the move rather than being on the wait for them to make their own decisions.

Mr. LANDRY. Particularly if we're going to be able to hold Commissioner Van Miert to his position that we will build upon the opportunities that have been negotiated up to the time of the EC-U.S. bilateral takes place. We ought to have as much in that foundation then as we possibly can. Many people think that's what the U.K. just did with regard to Seventh Freedom.

Mr. OBERSTAR. They've moved in that direction and I think that offers some opportunities for us.

I thank you very much for your contribution today. It was very stimulating, very, thoughtful.

Mr. LANDRY. Thank you, Mr. Chairman.

[Mr. Landry's prepared statement appears on page 350.]

Mr. OBERSTAR. The subcommittee will take a recess until 2 p.m. while members conclude other business.

[Whereupon, at 1:15 p.m., the subcommittee recessed, to reconvene at 2 p.m. the same day.]

AFTERNOON SESSION—2 P.M.

Mr. OBERSTAR. The subcommittee will resume its sitting.

Our next panel consists of Mr. Barney Parrella, senior vice president for Economics and International Affairs, for the Airport Operators International; and Mr. Samuel Keiter, vice president international, Kurth and Company, on behalf of the U.S. Airports for Better International Air Service.

Mr. Parrella?

TESTIMONY OF BARNEY C. PARRELLA, SENIOR VICE PRESIDENT, ECONOMICS AND INTERNATIONAL AFFAIRS, AIRPORT OPERATORS COUNCIL INTERNATIONAL; AND SAMUEL C. KEITER, VICE PRESIDENT INTERNATIONAL, KURTH & CO., ON BEHALF OF THE U.S. AIRPORTS FOR BETTER INTERNATIONAL AIR SERVICE

Mr. PARRELLA. Thank you, Mr. Chairman. It is a pleasure to be here this afternoon. This is my first appearance here before the

subcommittee. I am very pleased to give you the views of the U.S. AOCI membership on the subject of this hearing.

AOCI, as you well know, represents the local, regional, and state governing bodies that own and operate the principal airports served by scheduled air carriers.

We commend you, Mr. Chairman, for continuing to hold oversight hearings on the important subject of international aviation, and for your leadership in aviation as we try to shape the future of this very important sector of the global economy.

As the governmental entities at the State and local level with the most direct involvement in aviation, U.S. airport operators have a keen interest in the directions and trends of the aviation industry, and government policies and practices affecting aviation. In their dual role of proprietor of aviation facilities and catalyst for regional economic development, airports have become increasingly active in promoting and protecting their interests in aviation matters.

This activism has become particularly focused in recent years in the area of international air service. Over the past decade, U.S. airport operators have participated directly in the U.S. international air service process as observers on the U.S. negotiation delegations. The AOCI U.S. Bilateral Program provides a means through which the views and interests of U.S. communities and airport operators are conveyed to the U.S. negotiators, and the progress of the negotiations are reported back to interested airport operators. With some 68 participants, the Program has achieved an important and continuing level of contact and interaction between community interests and the negotiators at the table. Those negotiators have quite a task in front of them, as was evidenced by earlier testimony in a very complicated and dynamic area.

As we all know, the international aviation environment is strictly regulated by national governments and is restricted by various bilateral international agreements. The structure of many of these agreements in our view limits the opportunities for air service expansion to piecemeal additions to or extensions of existing routes and services. As a result, the opportunities and benefits to communities which flow from better access to the global economy tend to be severely restricted. I am talking now about the structure of the bilaterals as opposed to the job that the Department has been doing—the Department of Transportation, Department of State—trying to wrestle with intricacies of particular negotiations.

U.S. communities of all sizes, locations, and circumstances are seeking to enhance the quality of their international air service. There are communities with strong origin/destination markets that are experiencing continued growth; communities with strong tourism and leisure markets; communities with strong business travel demand; communities with demonstrable untapped potential for more direct international air service; communities seeking a more diverse range of competitive air service options for travelers and shippers; communities with specialized market characteristics; and obviously communities with a combination of all of these characteristics. It is a very diverse set of communities out there that all have a little bit different interest in the air service at issue in any particular bilateral negotiation.

The diversity and multiplicity of communities having an interest in these matters often results in competition among them for the particular new or expanded services which are on the table during the negotiations. This competition points to the underlying inadequacy of rigidly defined and inflexible bilateral agreements as a means of identifying and satisfying market demand. They know that the new or expanded rights that will come out of the negotiations will, in all likelihood, be very limited and that this will be, in all probability, the last opportunity for expansion in that particular market for years to come, until the two sides get together again and talk about it.

Out of this diversity of community interests and frustration with business as usual comes a common denominator among U.S. communities and airports. The provision of international air services should, to the maximum extent possible, be determined by the interplay of market forces. Government restrictions on the commercial decisions of air carriers should be kept to the minimum necessary to achieve such public interest objectives as safety, security, and environmental protection. Liberalization of the air transport regime is the objective that we, Mr. Chairman, urge all governments—our government, foreign governments as well—to seek.

Bilateral route rights have historically been exchanged based upon agreement by both sides that a balance of benefits has been achieved. Traditionally, that assessment has been based largely on the impacts on and opportunities for air carriers. Only recently have these assessments begun to show a recognition that community interest should be afforded substantial consideration within the priorities of the bilateral negotiations, and in the subsequent decisions on route transfers and replacements. We commend the Administration in the last several years for moving very aggressively in that direction.

The air traffic in a market, we feel, is largely the result of the economic market base of the communities at each end of the route. The airline that provides the service has, of course, a commercial interest in the economic success of its service. That airline does not, however, we submit, have a right to the traffic in the market in which it operates. Traffic springs from economic activity in the communities and in the regions, in the catchment areas of the Nation's airport operators. This fact alone justifies the conclusion that community interest should be given at least equal, if not greater, consideration than that afforded air carriers in governmental consideration of how air traffic demand should be met.

We applaud recent efforts by the Administration to open up international markets and take a broader view of air service development. Secretary Skinner's "Cities Program," whereby exemption authority can, under certain circumstances, be granted to willing foreign air carriers in international markets lacking non-stop or one-stop/single plane service, is welcome but very limited extra bilateral step toward meeting the need for expanded service. We also welcome recent policy statements and initiatives by the Administration which are oriented toward a more liberal approach to international air services.

We also understand, Mr. Chairman, that it takes two or more parties to enter into agreements on air services. We cannot impose

our perspectives on other governments. However, we can and should take every opportunity to place as much reliance on competitive market forces as can be made acceptable to our aviation partners.

That opportunity is directly before us. Negotiations on a new air services agreement with Canada are about to begin. These negotiations affect our largest single, but also a relatively poorly served, international air transportation market. A liberal agreement with Canada has the potential for vastly expanding the size, quality, and diversity of air services between the two countries, with the resulting economic and social benefits to citizens on both sides of the border.

U.S. airport operators sincerely hope that these negotiations will be successful and will expeditiously bring an expansive liberalization of air services in the U.S.-Canada markets. In October of last year at our Annual Conference, U.S. airport operators endorsed a resolution, which is attached to my testimony, urging the U.S.-Canada air service negotiations to proceed with the goal of achieving an open skies agreement and the significant expansion of trans-border air service. The resolution also accepts the proposition of cabotage rights for airlines of each country, if that is necessary for the successful conclusion of that agreement.

Just to add a few words here, we are not saying and we are not supporting cabotage as an end-all solution to the aviation environment in any particular negotiation. The two governments have indicated a willingness to put it on the table and to discuss it. As far as airport operators are concerned, if the two governments agree that it should be a component of the agreement, we would support that. I think there are broader benefits that can be achieved as a result of the negotiation in all of its aspects, and if cabotage is what it takes to put that together, we would support that.

Each community in this country has a unique air service market demand requiring different air service levels and types. The route and service structure codified in the patchwork quilt of bilateral agreements over the past half century simply does not provide the flexibility and dynamism required to meet the underlying international air traffic demand of communities.

The unprecedented expansion of the airport and airway infrastructure is now achievable, largely as a result of the landmark PFC and FAA reauthorization legislation enacted last year through your leadership, Mr. Chairman, and the dedication of the members of the subcommittee. The regulatory regime must also foster a new period of liberalization and opportunity for communities, for air carriers, and for the travelling and shipping public.

Mr. Chairman, that concludes my prepared testimony. I would be pleased to address any questions you or other members might have. If you want to address that now or—

Mr. OBERSTAR. I think we will proceed with Mr. Keiter. I want to thank you very much for a very thoughtful presentation, carefully delivered and carefully prepared.

Mr. PARRELLA. Thank you, sir.

Mr. OBERSTAR. Mr. Keiter, welcome. We are glad to have you before our subcommittee and to have your formal presentation this afternoon.

I would also like to thank you for the assistance you provided last December for the subcommittee in preparation for our visit to Canada in meetings with Canadian authorities on U.S.-Canada aviation trade. Your insights and experience on that subject were most valuable and very much to the point, as we found out when we got into those sessions.

Mr. KEITER. Thank you very much, Mr. Chairman. I know that in addition to the pleasure and satisfaction that we here in the United States had at the interest that the subcommittee is taking in that negotiation, many of those on the Canadian side were also interested in an expansion of the relationship. We are very pleased that you took the trouble to go up and have a look for yourself in Canada.

Mr. Chairman, I propose not to read my entire testimony, unless you would prefer me to do so.

Mr. OBERSTAR. It will be included in the record in full. You may summarize as you wish.

Mr. KEITER. I may say that I hadn't realized we had been as successful as we apparently have been in influencing AOCI's views. In listening to Mr. Parrella, I had the feeling that maybe he had been looking over my shoulder. So if you will forgive me if at some points I am saying much the same thing that he has already said today.

Mr. Chairman, ladies and gentlemen, the present international aviation regulatory system is a noose around our cities' necks, choking off needed economic growth. It is time to loosen that noose, or even to remove it.

Before I get into the substance, let me give you a little background. Before joining Kurth and Company in 1987, I had spent 30 years with the U.S. Foreign Service, the last 10 of those years in international transportation matters, most of them mostly concerned with aviation.

Kurth and Company has represented Baltimore/Washington International Airport, Kansas City International Airport, and occasionally other airports in USA-BIAS affairs, but I am here today for the group as a whole. And while the responsibility for what I say is mine alone, I have attempted to reflect the views of the group.

USA-BIAS, the United States Airports for Better International Service, is a coalition of 26 airports in 22 States. Together, we account for over one-third of all U.S. enplanements. We represent in general the hungry, second tier of U.S. airports—those who feel that if only the regulatory system would allow, they would be able to support a much broader international air service pattern.

USA-BIAS operates on a consensus basis with an opt-out clause. If any member doesn't want to be associated with any particular initiative, it simply chooses to not participate.

Why did we feel it was necessary to create USA-BIAS in the spring of 1989? Essentially, because U.S. communities were tired of seeing the financial interests of airlines put ahead of wider community and national interests in our international aviation negotiations. Mr. Parrella has referred to AOCI's activities in this area, but even those date back only to 1983. Prior to that, there was no community representation on U.S. negotiating teams, even though

other elements of the industry, including both airlines and airline labor, were represented. And even after there was some representation, it turned out to be primarily a reporting function, which is very essential, but the other part of the equation, the response to a negotiating situation, wasn't happening quickly enough to be effective, and USA-BIAS was created to step into that breach.

We think that we have been substantially successful in that. Our friends at the Departments of State and Transportation tells us that now community interests are factored into our negotiations and we think we see evidence of that in individual negotiations. The Cities Program, to which Mr. Parrella referred, established in January of 1990, is another example, a very important move to essentially say to U.S. airlines, "You don't own the traffic." If you aren't going to provide the services that are needed when you could, we are, under certain circumstances at least, going to let somebody else do it.

But we can't relax. There is a lot farther to go to achieve the kind of economics-driven international aviation that we and the AOCI are looking for. And even to maintain the gains that have been made to date mean that we have to continue to be involved on a day-to-day basis.

Why, may I ask, are communities concerned about international air transportation? Basically, the answer is very simple. Transportation is the key to prosperity; a truth that has been recognized by governments, including our own, for hundreds of years. Communities shouldn't even have to answer the question with specific reference to international air transportation, but they have been asked to by government, by airlines, by others. Up until about a year ago, the information we had was relatively anecdotal, but at that time 11 members of USA-BIAS asked Kurth and Company to put together a study to try to develop a more general sense of the value of international air transportation. We were able to show that first daily service on a particular international city pair, either across the Atlantic or across the Pacific, will result in increased economic activity in the United States, primarily in the area of the U.S. gateway, of between one-fourth and three-fourths of a billion dollars in the first year. That number increases with natural growth in each succeeding year. If growth is 5 percent a year, that means doubling in 15 years.

Perhaps equally importantly, the benefits to the United States are essentially independent of what airline provides the service; it doesn't matter if it is a U.S. airline or a foreign airline. In general, foreign airlines tend to carry more visitors to the United States who spend money in the United States and that offsets the actual ticket receipts that a U.S. airline might receive.

USA-BIAS' basic aim is to achieve U.S. Government support for the proposition that U.S. aviation negotiators must take U.S. community and national economic interests fully into account, giving them precedence over airline and other aviation industry interests where communities and the nation have more at stake. In a free market economy like ours, economics, not regulators, must determine the winners. We would welcome this committee's support in this endeavor. Ideally, that might be in the form of an amendment to section 1102(b) of the Federal Aviation Act; that has the advan-

tage of being permanent. But even less formal expressions of support would represent a major step forward in our efforts.

More specifically, USA-BIAS is looking at three particular areas at the current time. The first is our relationship with Canada, the second is the general international aviation climate, and the third is the possibility of improving the Cities Program.

Our current bilateral agreement with Canada is antediluvian, with deregulation in the United States representing the flood. And even in the pre-flood days, the U.S.-Canada relationship was a particularly restrictive one. Today, with deregulation on both sides of the border, it is simply out of phase with everything else.

We in USA-BIAS estimate that the U.S. city that could have had a daily service to a Canadian city but didn't get it because of the bilateral, lost \$120 million in the first year. Now, that doesn't sound like a lot, but it adds up quickly as you add up the number of services that you might have had. Looking at it from a slightly different perspective, we have concluded that U.S. and Canadian communities together in 1989 did not have \$9.3 billion of economic activity because of opportunities that had been lost because of the bilateral since 1980 alone.

Now, as Mr. Parrella has indicated, there do seem to be steps in the right direction. Secretary Skinner and his Canadian counterpart announced in October that they intended to achieve an open transport or aviation regime, one in which the driving force would be economics. The United States even agreed to discuss cabotage, which, unfortunately, it had not been prepared to do five years ago, when, incidentally, I was very much involved in the attempt to achieve an open agreement at that time.

And, of course, the committee's interest—and, as we understand it, the committee's willingness to consider the amendment of the cabotage legislation in the Canadian context on the basis of the national interest—is also an important development.

USA-BIAS welcomes these developments, even though the actual negotiations seem to be taking a little longer to get started than we had originally hoped. We will, of course, be following developments both in the negotiations and in any subsequent legislative endeavors to try to ensure that both negotiators and legislators keep their eyes firmly focused on the national interest.

Unfortunately, overall developments in the international aviation arena have not been as favorable. In fact, they have been decidedly unfavorable. The Thais, for example, denounced their liberal bilateral agreement with us and have allowed it to expire. The French and the British in somewhat different circumstances have each managed to put additional restrictions on U.S. airlines, and, in the British case, even managed to get us to pay for the privilege. In that context, I would like to mention that USA-BIAS would like very much to take British protestations that they intend to negotiate a truly liberal bilateral regime within the next few months at face value. We have been disappointed with the British in the past and we don't see them out there trying to mobilize international opinion, neither the British Government nor British Airways, in favor of the kind of liberal regime which they claim to desire. Until they are prepared to do so, their words are empty and simple excuses.

Partly at the urging of USA-BIAS, as Mr. Parrella said, the United States has offered open skies agreements to the U.K., Germany, and France. The French said, no; the Germans have dilly dallied, and continue to dilly dally; the British said, sure, just as soon as you let us have free access to your internal domestic traffic. Perhaps we would have been better off to stand up to the British over the Heathrow issue. You all know the old saying that you get more flies with honey than with vinegar. But in dealing with the United States in aviation matters, the British have done very well with vinegar. And our other partners, such as the Germans, can't help but notice.

Mr. OBERSTAR. I am going to have to interrupt you at that point, Mr. Keiter. We are down to the last five minutes on this recorded vote.

We will take a brief recess and will come back shortly.

[Recess.]

Mr. OBERSTAR. Mr. Keiter, you were in the closing moments of your presentation, or coming close to that, of following the general outline of your prepared remarks. We would like you to resume.

Mr. KEITER. Thank you. I was just saying that we cannot avoid the fact that when we negotiate with one aviation partner, other aviation partners notice what happens. I just wanted to conclude that surely our negotiators and administrators must be able to find some way to demonstrate to our aviation partners that when it comes to dealing with the United States in international aviation, liberalism pays. If it doesn't, why, we can hardly expect them to adopt it.

Basically, the problem is that the traditional role of aviation authorities in international aviation throughout the world has been to protect the national carrier or carriers, and that remains the situation in the vast majority of countries. People with a broader outlook tend not to be involved in international aviation policy.

At one point, some of us in USA-BIAS thought that the negotiation of a General Agreement on Trade in Services might provide an opportunity to break out of this traditional framework. Unfortunately, it appears for a number of reasons that that hope is unrealistic. I can get into that further in the question period if you want to address it. Similarly, on a slightly different front, we have seen no evidence so far that a united Europe will be more liberal in an aviation sense than the major European aviation countries have been up until now.

Turning to USA-BIAS' third area of immediate interest—the DOT Cities Program, I want to re-emphasize that we consider this to be an important departure, but a departure that was made in a cautious manner and, to some extent, an inconsistent one. One might argue about just what parts of the program are inconsistent with its basic thrust, but I would suggest that we can all accept this principle—when U.S. airlines choose either not to provide international air service between a particular U.S. city and a particular foreign city, or to provide inferior service, foreign airlines should be allowed to provide the service or the service improvement, provided that their homeland has a pro-competitive bilateral agreement with the United States.

In USA-BIAS' view, that principle implies certain specific changes in the Cities Program. First of all, it would mean that existing U.S. carrier service would block service under the program only if, first, there was already U.S. carrier service on the same city pair, and not only between the U.S. city and the same foreign country, as is presently the case; and, in addition, if the U.S. carrier service were of equivalent quality. It simply makes no sense at all for one-stop service to be allowed to stop non-stop service. The Department of Transportation's own service quality methodology recognizes that non-stop service is worth at least twice as much as one-stop service.

As far as U.S. carrier plans are concerned, if they are not to thwart the thrust of the program, they must pre-exist the foreign carrier application and, in addition to the other tests, must meet a public interest test.

Second, the restrictions that the Department of Transportation has placed on third country traffic and the advertising of connecting services to third countries should be removed if the non-stop service to the U.S. city is less than daily, or if the U.S. carrier service to the ultimate foreign destination is inferior. The first applies because what we are trying to do is to provide quality service to U.S. cities, and I think those in the industry generally agree that less than daily service is simply not of the same quality as daily service in the international arena. And as far as the question of quality is concerned, for example, if Swissair were providing service between Baltimore/Washington International and Zurich, a traveller could travel from BWI through Zurich to any number of points that Swissair serves beyond Zurich that U.S. carriers do not serve at all. Under the present regime, travellers' ability to make use of that service is limited by the terms of the program.

Third, the foreign point should not necessarily have to be in the foreign carriers' homeland. That restriction is simply left over from bilateral thinking and it is time for the United States to start thinking about a world-wide regime. And certainly, insofar as we are talking about a program that is intended to benefit U.S. communities and where which foreign carrier provides the services, as long as we have a pro-competitive agreement, is immaterial; there is no reason to make that connection.

Fourth, all-cargo services should be included in the program. As I said earlier, transportation is the key to prosperity, and it doesn't really matter whether we're talking about the transportation of people or the transportation of goods.

And finally, the 90-day start-up provision should be removed. That was introduced on the basis that that's what we require of U.S. carriers who are competing for limited entry route rights. The situation with regard to the Cities Program is entirely different, and, in fact, does prevent many small foreign carriers—and most foreign carriers are small by U.S. standards—from making applications.

Mr. Chairman, members of the committee, international aviation is by definition international, and the U.S. cannot impose its philosophy by fiat. But it can seek opportunities to put international aviation on a more economic basis, both in cooperation with willing partners, like Canada, and on its own, as through an improved

Cities Program. USA-BIAS believes that its member communities and, indeed, the United States as a whole, will benefit from the expansion of international air service. It will continue to strive to ensure that approach permeates U.S. international aviation policy. We hope that you will join us in that task.

Thank you very much for this opportunity to testify.

Mr. OBERSTAR. Thank you very much, Mr. Keiter. We greatly appreciate your long years of service that you've provided to our country as a negotiator in the field of aviation trade and your experience since leaving the public service. You bring a very valuable and insightful perspective.

Mr. Keiter, you observe that united Europe is not likely to be more liberal than the individual countries that make it up. Secretary Skinner and Mr. Shane both have offered the viewpoint that they have high hopes for a much more liberalized regime for aviation trade with the post-1992 Europe. In what ways do you view that differently? What leads to a viewpoint that a single internal market, consisting of some 340 million people with greater dynamism, now including the unified Germany, will not be as open to competition as its individual pre-unification members?

Mr. KEITER. Mr. Chairman, I think that there are a couple of reasons for that. One is that we're in different positions. It is the role of the diplomat, and in this context Mr. Skinner and his counterparts at the Department of State are diplomats, to be an optimist. You never give up before you start. If I were in their shoes, I would have that same requirement. As an analyst, I can afford to take a more neutral approach.

Secondly, I think that I was looking a little bit more at what we have actually seen come out of Europe up until the present time as opposed to what the dynamics may be once union is accomplished. I have not entirely given up hope that the internal dynamics of a larger market will drive Europe toward a more liberal international aviation approach, but I have pretty much given up the hope that we'll begin to see evidence of that before union actually takes place. At one point, it appeared that the Commission and its staff might move Europe more quickly toward a more liberal approach. It now appears to me and my colleagues at USA-BIAS that we're going to have to wait for the whole process to go through for there to be a united Europe and for that larger market to bring about a change in perceptions and viewpoints.

Mr. OBERSTAR. Mr. Parrella, you expressed a view that I think may to a degree be shared by Mr. Keiter, that traffic is largely the result of the economic base of the community at each end of the route, as you put it very well, and, therefore, community interest should be given equal consideration to those of the carriers. That's why we have airport authorities, that's why the public interest is expressed on that side of the aviation service. I think it is a good balance, it is a very important balance, and one that I worked very hard to preserve in the legislation that we enacted last year to enhance that community interest.

But then Mr. Keiter went on a little further to say that if U.S. carriers aren't providing service to a community, or aren't providing it at a fare-competitive price, or where they have a fortress hub, I assume you by inference mean, then foreign carriers should

be permitted to do so. That's a new step in a new direction without any qualifications, and I will get back to Mr. Keiter, but what are your views on broadening service and going, by inference at least, beyond the city pair concept that the Department has launched?

Mr. PARRELLA. You have to have a carrier and community together on a particular service. To have an effective service, obviously you need two ends of a route and you need a carrier willing to serve.

The situation in terms of a foreign carrier interested in serving a route which is currently not being served on a non-stop basis by a U.S. carrier, as far as the community is concerned, it is looking for the service; the flag on the tail is really not of consequence to the economic development in the community. I think that would be a general approach that I would espouse.

Now, I know, and I think we all know, that in particular communities there is a very great presence of a particular carrier, a hub operation, a major employment center, a maintenance base, a variety of aviation economic activity in that location which is very important to the community and which is very important in terms of that community's access to the international air transportation system. And in communities in that circumstance, typically they are well served in terms of the service options that are available. But I would submit to you, Mr. Chairman, that if there is an unserved non-stop market in that community and there is a willing carrier of any persuasion—a U.S. domestic carrier, or a carrier licensed and operated by U.S. interests, a foreign carrier—that carrier ought to be provided an opportunity to serve that market in the absence of a fit, willing, and able carrier that wishes to provide it from the domestic side.

Mr. OBERSTAR. Thank you.

Mr. KEITER. Mr. Chairman, if I might. I think that the problem more often arises with regard to U.S. cities which are not domestic hubs, that U.S. carriers tend to prefer to provide international air service out of their hubs, and that means that other cities can get U.S. domestic carrier international service as well as domestic service only via one of the hubs. So, for example, if Continental has a hub in Newark, it is likely to provide service from Kansas City, say, to Europe only via Newark.

A European carrier whose hub is on the other side of the Atlantic may feel differently about it and be willing to provide non-stop service between Kansas City and the European continent. I think our suggestion is that if that is, in fact, the case and there is no U.S. carrier willing to provide that non-stop service, a foreign carrier should be allowed to do so.

Mr. OBERSTAR. Thank you. I'll have further questions in a moment, but I would like to recognize the other members at this time.

Ms. Molinari.

Ms. MOLINARI. Thank you, Mr. Chairman. At this time I have no questions. Unfortunately, my schedule has precluded me from enjoying most of these gentlemen's testimony.

Mr. OBERSTAR. The gentleman from Missouri, Mr. Hancock.

Mr. HANCOCK. No questions at this time, Mr. Chairman.

Mr. OBERSTAR. Do you think the pair cities program though is significant enough of an exchange for growth? It is an interesting opportunity that the Department is offered, where a U.S. carrier is not interested and another foreign carrier wants to serve, the community wants the service, the carriers don't object, it is fairly limited, it does plug some gaps but it seems to me to be of rather limited application.

Mr. PARRELLA. That would be my conclusion as well, Mr. Chairman. I think it is certainly valuable for the cities to obtain the service under the program. It happens to have occurred, I think, during a time when maybe expansion of some of these opportunities has not been as great as might otherwise have been the case, speaking about general economic conditions, and the lower propensity to travel in the international market situation we've seen over the last six or nine months, but it is a good program and we would hope that it would be expanded in terms of its applicability.

It does not replace or supplant, if you will, the need for the bilateral structure and the bilateral process to go forward with a more expansive set of ground rules. Again, the common denominator among U.S. airport operators is that we're talking markets, we're talking about economic entities and regions that are interacting, not solely air carrier interests.

Mr. OBERSTAR. Put on the hat representing the last category in your organization's title, "international." You have associates in Europe—let's focus on Europe for the moment—you have associates and meet with them regularly, exchange views, those airport operators have views that differ from those of their national carriers, although they seem to be tied a little bit more to their national carrier than our airport operators are in this country for a variety of reasons. But take the example of the Amsterdam Airport, for years it wanted to exchange service with the Minneapolis/St. Paul and never could quite get Northwest Airlines to offer service from the Twin Cities to Amsterdam. The Minneapolis/St. Paul Airport operators wanted to have exchange service between Minneapolis/St. Paul and Amsterdam. It was thought to be a very good, productive service. That city pair exchange didn't come about until just recently when Northwest indicated it had no intention to serve and no objection to KLM offering that service.

That development just seems to me was not entirely coincidental and unrelated to the acquisition by KLM of a substantial interest in Northwest Airlines. As I observed in these committee hearings, when KLM bought a 57 percent interest in the equity of Northwest Airlines, they didn't buy a ticket to the game, they bought a seat on the bench next to the coach, and they obviously whispered in his ear that this is something he ought to do. Now, there are some interesting implications for cross-investment. If European airlines are allowed to increase their equity ownership of U.S. carriers, you may see more of these city pair deals arranged. But it just strikes me that that's a poor substitute for a broader regime of negotiation of a wide range of rights and interests that serve the United States and our trading partners far better than these coincidental sort of arrangements.

Mr. PARRELLA. I would agree with that, Mr. Chairman. Certainly, it is not for me, sitting here as the representative of a trade asso-

ciation of which Minneapolis/St. Paul is a member, to comment on that specific instance, but—

Mr. OBERSTAR. But expand on—do the European airport authorities have a different view about these matters that have been so sticky—cross-investment, cabotage, internal service, pair cities, and so forth?

Mr. PARRELLA. Well, on the pair cities, there is an increasing recognition and, in fact, activism by airport operators in Europe, for example, and in other places to actively promote and seek that service. A couple that come to mind, the Manchester Airport, PLC in Britain, others, have been very active in terms of doing the marketing, doing the carrier visitation which really needs to occur as a part of that, looking for the opportunities, looking for the willing carrier, and then trying to expand the service to their communities. So there is an activism there.

On the ownership, foreign investment, my observation is that is tied in very much to the overall evolution of the single internal market in Europe. They have—my observation, again, and not speaking on their behalf, but just observing from the outside—a great debate occurring within Europe in terms of how the internal market will be structured, how carrier nationality issues will be addressed, which is well up in the air; it is unresolved, the jury is still out on it, as we've heard in some testimony here in the past few days on that subject. And so it goes quite beyond what I would say any particular airport in Europe or elsewhere can really address. But the bottom line, in terms of discussions I've had with airport directors in Europe and elsewhere around this country, is an increasing recognition of the community perspective, the basis for the traffic that is the regional and local market, and the need for the airport operator and the community business interests and travel interests to work together to make service happen, as opposed to letting that service evolve as a result of decisions which are made between airlines and governments.

Mr. OBERSTAR. Do you have any fear that a cabotage arrangement would result in disservice to some cities and enhance service to others? That is those smaller or medium range non-hub communities, and even some of the hub cities, might not appear to European carriers to be very attractive markets. They might come in and skim the cream off of just a few cities and leave many others under-served and, thereby, discouraging in fact further carriage by U.S. airlines.

Mr. PARRELLA. Mr. Chairman, on the cabotage issue, the AOCI membership has really only looked at it in the context of the U.S.-Canada situation. Let me just address that a little bit.

Mr. OBERSTAR. Okay. Well, then address the Canada question.

Mr. PARRELLA. And maybe Mr. Keiter can help on the other side. In terms of Canada, as I indicated in my testimony, both governments have indicated a willingness to put it on the table. We are not promoting it as the end all objective of these talks. But we would observe that the last 12 years of deregulation have taught the U.S. airline industry how to compete. It would be my observations that if the lessons haven't been learned as to what it takes to compete in an open and active market, then school is out at this point.

From the U.S. airline perspective, I wouldn't see what they would be concerned about vis-a-vis cabotage in the U.S.-Canada market. This is my personal observation. We understand that there are fears on the other side of the border in terms of what would happen to the Canadian industry, but certainly from where the communities are sitting in this country, they would anticipate—and I think they could expect to see—an enhancement of services that simply are not present currently in the trans-border markets.

And then as to whether there is a significant impact in domestic carriage, that's an unanswerable question because it really asks the question of how will cabotage be defined in such an agreement. If you take it from one extreme—just wide open, let everybody set up whatever they want to set up—as a practical matter in the Canadian context, that is not going to be a major factor in terms of volume of operation and volume of impact. If it is something somewhat more limited—a defined cabotage, restricted cabotage with fill-up rights or rights to operate in a defined set of markets—the impact may be even less. But if that is what it takes for the U.S.-Canada deal to be cemented and to go forward, the U.S. communities are on board. We would like to see that go forward.

Now, Europe is a much bigger playing field and we don't really have a position.

Mr. OBERSTAR. Well, you know, is it fair and equal? I think everybody's talked about fairness and equality of opportunity and access. But for the Netherlands—my congressional district is bigger geographically than the whole of the Netherlands. In fact, I've got maybe four counties that are the size of the Netherlands. And if they say, "In return for cabotage and access to any point in the United States we'll give you cabotage in all of the Netherlands." That's not getting very much. I mean, they've got two airports there, come on.

Mr. KEITER. I don't think anyone—

Mr. OBERSTAR. Yes, 11 million people, I know about it.

Mr. KEITER. It does make a difference. I don't think even the Dutch are pushing that kind of a proposal at the present time. And, really, the live issue, although it's taking its time coming to fruition, is going to be whether we should have an exchange of cabotage rights in some form with a United Europe. Which is, of course, a quite different animal.

Mr. OBERSTAR. That's the big issue here.

Mr. KEITER. As to whether cabotage might benefit only larger hubs, my sense would be that in any case where you tend to offer a limited opportunity, limited in size, the recipients of that opportunity will do everything they can to use it in a way which maximizes their benefits. So if they think that they can do best by skimming the cream on the big markets—which I would doubt, incidentally, because they'll be up against some of the biggest, strongest carriers in the world—then that's what they'll do.

On the other hand, it's clear that the possibility of fill-up rights would make it easier for a Canadian carrier, for example, to serve two smaller points in the United States when it could use the local traffic between them to build up its load factor to viable levels.

Mr. OBERSTAR. We have a long way to walk on all of these issues, and you've helped us think through some of the thorniest ones. We

really appreciate your participation. We hold you excused, and thank you, again, very much. I'm sure we'll be consulting with you and talking with you about these matters further as the United States continues with its negotiations and its deliberations on these matters.

[Mr. Parrella's prepared statement appears on page 366.]

[Mr. Keiter's prepared statement appears on page 334.]

Mr. OBERSTAR. Our next panel includes Mr. Marshall Sinick, Washington counsel for Alaska Airlines; and Mr. Igor Dmitrowsky, president of Baltia Airlines. Welcome, and thank you for being with us this afternoon.

Mr. Sinick, do you wish to begin?

**TESTIMONY OF MARSHALL SINICK, WASHINGTON COUNSEL,
ALASKA AIRLINES AND IGOR DMITROWSKY, PRESIDENT,
BALTIA AIRLINES**

Mr. SINICK. Thank you, Mr. Chairman, and members of the Committee. Once again, Alaska Airlines is here—as we were several weeks ago, on February 5 to be specific—to urge that this committee seriously consider, and hopefully take legislative action to make, what we feel are sorely needed mid-course corrections, to use an often used phrase, in a number of the policies of the department which we feel are heavily skewed in favor of what we often hear of, the mega-carriers.

We are quite disturbed, as I hope some of you are, about the Secretary's statements last February where he predicted, and I think has even taken as accepted fact, something which we heard discussion about this morning, namely that there will be perhaps as few as three, but probably no more than five, U.S. carriers in the not too distant future. And I think Mr. Kasper this morning agreed with that calculus. And the Secretary, and I think Mr. Kasper also, seemed to imply that he didn't envision that such a result would produce any loss of consumer benefits.

Alaska could not disagree more strongly. While we don't know for certain, we tend to doubt that we're in the calculus of either the Secretary or Mr. Kasper. Alaska, along with its affiliated carrier, Horizon Air, which it wholly owns, is a billion dollar company. It has over 7,500 employees. We've had 18 consecutive years of profitability. We're doing better than most today, even in these very difficult times, we suspect. We have every intention of being around. We're also not here—I want to make it very clear—seeking a Federal bailout.

We were one of the first carriers to openly oppose the recent attempts to secure legislation to have the Federal Ticket Tax retained. We had no sooner heard about it than we opposed it and probably created some animosity between our brethren carriers; but so be it, we feel very strongly about those kinds of things.

But when it comes to the Department, we're feeling increasingly frustrated when we see so many of the Department's policies which seem to be so heavily tilted in favor of the larger carriers. And I would like to just go over a few of those with you and then give you some suggestions in terms of what we'd like to see in the way of corrections. I think it's fair to say that we're not even sure we're

on the Department's agenda at all since we're fairly certain we're not amongst those three to five carriers that the Secretary and others have spoken about in recent weeks.

If you look at the Department's policy, concerning the liberalization of foreign investment, we're strongly opposed to that. And I'll speak to that in a few moments. The Department's carrier selection policy, which is I think part and parcel of the same thing, is very heavily tilted in favor of the large mega-carrier. As for the Department's route transfer policy, much the same can be said. And I would also like to talk about the U.S.-U.K. bilateral agreement, which was just concluded. We're quite disappointed in terms of some of the provisions of that agreement. Specifically, some of the Fifth Freedom awards the Department made in conjunction with the State Department to the British gave away rights in some markets we'd dearly love to have and in which we have been unsuccessfully seeking entry for more than a year. And to depart, there is from the international focus of this hearing, one other issue that we did raise earlier in February, and I think it's quite timely. It's the famous or infamous, perhaps, CRS issue.

We and the other small carriers have been beating on the Department to try and get them to take action to bring us some relief on the so-called CRS booking fee issue. We pay an absolute fortune to the vender-carriers, far above their costs of providing that service. We understand, as I sit here today, that either today or tomorrow the Department is going to finally release its Notice of Proposed Rulemaking. But we've been led to believe there will be no action once again on the famous CRS booking fee issue.

Now, to elaborate a little more on some of the points I've raised. Carrier selection proceedings. We've reviewed the recent carrier selection proceedings that the Department's held, and I think with perhaps one exception we could not find a single instance where a plum route has gone to a so-called smaller major or national carrier. The one exception, I guess I would say, is the Honolulu-Tokyo award to Continental.

Why does that take place? Look at the criteria the Department applies when it decides whether it's carrier A, B, or C. You'll find in most instances the criteria that seems to swing the decision, at least as it's articulated in the Department's decision, is the so-called beyond area benefit criteria, namely how many cities does the U.S. carrier serve behind the U.S. gateway through which it can provide single plane service or on-line connecting service through the gateway to the foreign city? Obviously, that criteria plays directly into the hands of the mega-carriers who have virtually omnipresent domestic networks. And when you get into that numbers game as it were, guess who's going to lose. The smaller carrier is going to lose in each and every instance.

I think it's unfortunate that the decision-making in those kinds of proceedings has a very narrow focus. Never once do you see the Department saying what is the long-term structural implication of placing award after award in the laps of the large carriers while depriving the smaller carriers? What's the long-term consequence of that? They don't look at that kind of macro-issue.

And what we would like to see, because we don't see the Department's policy as likely to change absent legislation, is a legislative

correction in the section of the act that deals with the statutory objectives which would mandate that the Department afford decisional significance to a credible proposal, and I submit it has to be credible, put forth by a smaller major or national carrier in an international route proceeding, provided that proposal will have a positive, significant impact on that smaller major or national carrier's route system. And I sit here next to an individual from Baltia Airlines, and I sympathize a great deal with what they must be going through. They're not an operating airline, but as a smaller carrier or prospective smaller carrier, they're obviously laboring under very difficult straits given the kinds of policies that have prevailed at the Department.

In terms of the U.S.-Canadian agreement, which is probably the biggest upcoming bilateral negotiation, Alaska intends to be a very significant player because the Canadian markets, as are the Mexican markets, are major natural markets for us. We serve five points in Mexico today. We are concerned, that if you do not propose a route from a so-called fortress hub such as Atlanta, Denver, or Washington, that our route expansion priorities in terms of the deliberative process that the Department's going to go through are going to be front-end loaded, or only going to become effective five or six years hence. It will have very significant consequences for us where we come out on that agenda.

And we're quite concerned, again, that absent proposing a route from a fortress hub, that the smaller major and national carriers are going to come out with a far lower priority in the so-called negotiating agenda of the Department and the State Department. It's difficult to say that that could be corrected by legislation, but one would hope that some messages could be gotten across that perhaps it's time for a breath of fresh air and a change in those kinds of policies.

Much has been said today about foreign ownership and cabotage. I find it intellectually impossible to consider one without considering the other. Alaska has very strong feelings about cabotage because we feel that it's hard to envision that there could be a truly reciprocal trade of comparable value. Your Netherlands example obviously is an extreme just for purposes of discussion. But even in the Canadian instance, we find it difficult to imagine that there could truly be equitable economic trade-offs. We don't want to close the door on it, but we're very, very skeptical.

The foreign ownership question, it's our belief that if indeed one could assure that there's truly adequate economic benefits in terms of reciprocity, we'd be prepared to consider it. At the same time, we don't think anyone should be misled by the consequence that liberalized foreign ownership is likely to favor those U.S. carriers who are truly in need of that capital. Once you pull off the restrictions, the money is going to flow into the trophy properties. Certainly in the case of the Japanese, they have proven that that's exactly what they go after. I don't see any reason why anyone else would do anything any differently. I doubt that the weaker carriers are going to find that liberalization of the foreign investment rules are going to have any favorable consequence. Indeed, it could have the reverse effect. We could be providing added sources of economic

capital, not available to the weaker carriers, to the mega-carriers, who, frankly, don't need it in the first place.

We are quite concerned about the context of how the foreign ownership issue is addressed. We would very much urge that it not be addressed separately from the cabotage issue. They are just opposite sides of the same issue, as we see it. And we're very uncomfortable with ad hoc decision-making, which is, of course, what we had in the recent Northwest-KLM Decision.

I mentioned CRS before, and I know it is not officially part of the international agenda, although CRS systems certainly affect both domestic and international air transportation. We would very much like there to be legislation, because absent legislation, it is never going to happen, that would require the Department to amend its CRS rule to provide that when there is a legitimate dispute between a CRS vendor carrier, on the one hand, and a CRS participating carrier, such as Alaska or Southwest or America West, as to whether or not the booking fee is excessive, an outside arbitrator should decide that question on a final and binding basis.

We strongly suspect that if there were such a proceeding, there would probably be no more than one or two, because once a decision was rendered, the vendor carriers would quickly learn which way those were likely to go. It is not going to be a series of constant arbitrations. An arbitration mechanism would also avoid having to tie the Department's staff up with rate-making proceedings, which are something they certainly don't seem to show any real interest in. Failing that, we are going to continue to have to transfer literally hundreds of millions of dollars a year to the large carriers.

What we are doing in essence is subsidizing them, and they turn around and buy massive international route networks. We would do the same thing, undoubtedly. I am not faulting them for doing it, but they are just increasing the disparity in size between themselves and ourselves; and what really galls us is we are having to pay them and help them do it.

Once again, I would like to thank the subcommittee for the opportunity to appear. I trust that our testimony—and I can say it is shared in by folks at some of the other smaller carriers who feel somewhat disadvantaged; I have discussed it with American West's counsel—and our views do help spur the subcommittee to take action to try to put forth some legislative relief—what we here call mid-course corrections. All the smaller carriers and there are not many of us left would very much like to remain effective competitors. We think we offer a very positive contribution. In Alaska's case, we have a very loyal following, which I am glad to say is growing. I have already mentioned our record of profitability. We are a very soundly run airline. We have one of the best consumer complaint records in the industry and we hope we can continue it.

Thank you very much. I would be pleased to answer any questions.

Mr. OBERSTAR. Thank you, Mr. Sinick. You need not apologize for addressing subjects that are beyond the scope of this specific inquiry. Members of Congress do that all the time on this committee. [Laughter.]

And it is useful, especially the CRS booking fee issue, where you touch a responsive cord with the members here.

Mr. Dmitrowsky?

Mr. DMITROWSKY. Thank you. I have to introduce a new airline, Baltia Air Lines, of which you probably haven't even heard.

Mr. OBERSTAR. I'm sorry we don't have the Department of Transportation here for you to introduce yourselves to, as well.

Mr. DMITROWSKY. Baltia is a new start-up carrier that is now involved in the route authority process under the U.S.-U.S.S.R. bilateral. We are competing with some of the major carriers of the United States.

I would like to introduce an issue which may be a little bit contrary to some of that which we have heard here in testimony so far. Primarily, we have heard about the difficulties of negotiating bilateral agreements and the difficulties that the United States airlines have in implementing them in various countries, and also the necessity for the U.S. airline industry to have new airlines entering the marketplace. By contrast, focusing on the U.S.-U.S.S.R. bilateral, the U.S. negotiators obtained important rights, yet a recent Administrative Law Judge recommended against full implementation of those rights by denying a start-up carriers' proposal, the only proposal in the proceeding to fully implement the bilateral.

Let's start with the first one. About last June or July, the United and the U.S.S.R. concluded a new bilateral agreement that is in certain ways quite remarkable, especially when contrasting it with the previous bilateral U.S.-U.S.S.R. agreement. In fact, this new bilateral affords the United States airlines incredible rights. For example, it opens up a host of new cities both in the European part of the Soviet Union and also in the Siberian part. As an aside, I note that Alaska Airlines is the only airline that has proposed service to cities in the Siberian part.

The bilateral, permits U.S. airlines to operate non-stop services between the United States and the U.S.S.R., and, through a set of unique opportunities, it also permits a United States carrier literally to establish its own hub within the U.S.S.R. United States carriers need to utilize these rights to break the foreign domination over U.S.-U.S.S.R. traffic.

Of the U.S.-U.S.S.R. traffic which currently exists, about 80 percent is being carried by foreign carriers, like SAS, Finnair, Lufthansa, and several others. The services offered by these carriers are limited by the bilateral from which their authority is derived. As a result that can offer nothing more efficient than one-stop services from the United States to the U.S.S.R. United States carriers can offer a competitively superior product by utilizing the non-stop authority obtained for them by the U.S. negotiators. The only non-stop service that is currently being offered is that by Pan-American, from JFK to Moscow.

A carrier such as Finnair, that originates from a country which only has a population of 8 million, is able to market very successfully its product in the U.S.-U.S.S.R. market and is carrying the bulk of U.S. passengers. This is primarily a result of its large, if I could say, "network" within the U.S.S.R. for example, Finnair has the capability of deplaning passengers at one Soviet city and later enplaning them from other Soviet cities; namely, Leningrad and

Moscow. The United States can neutralize Fannair's advantage by selecting a U.S. carrier which proposes service to multiple gateways.

As a new entrant, when it proposed its service from the United States to the U.S.S.R. under the bilateral, Baltia Air Lines was under the impression that a new air carrier would be a welcome addition to the industry. We also believed that any entry into the market should be a strong one, that should be better than the current foreign competition. Consequently, we proposed non-stop flights from JFK to Leningrad five times a week, and non-stop flights from JFK to Riga five times a week. At Riga we have planned a hub at which two small aircraft are to be stationed that would provide services to the beyond cities of Minsk, Ibilisi, Kiev, and Moscow; in essence, feeding the trans-Atlantic flight. I have been referring, here in my testimony, essentially to the fact that Baltia's proposed service respond to the competitively advantageous bilateral rights that were obtained by U.S. negotiators.

Having gone through the Administrative selection process, we were somewhat surprised to learn that, for example, a two-stop service from JFK to Leningrad by TWA, which duplicates exactly what Pan Am is operating now, was preferred over Baltia's non-stop service. I would like to read a comment made in this respect why a larger carrier was preferred despite the fact that Baltia's proposal is superior by far. Let me cite from the Administrative Law Judge's—

Mr. OBERSTAR. What is the document you are reading from?

Mr. DMITROWSKY. This is the Administrative Law Judge's recommended decision to the DOT.

Mr. OBERSTAR. In which case?

Mr. DMITROWSKY. In the U.S.-U.S.S.R. North Atlantic Combination Service Case.

Mr. OBERSTAR. Thank you. We just need that identification for the committee record.

Mr. DMITROWSKY. He wrote:

I agree with Baltia's assertion that although fitness is not an issue in this proceeding, in fact, some parties have relied on fitness issues not germane to the proceeding in arguing that Baltia should not be selected. I am assuming that Baltia is fit, willing, and able to operate its proposed routes and that it has the managerial skills and technical ability to conduct its proposed service. Indeed, the Department has tentatively so concluded. I do question whether Baltia can operate a U.S.-U.S.S.R. route as well as an experienced, established carrier like TWA. That does not mean Baltia is unable to do so; only that TWA is better able to do so.

Well, I would say that this probably demonstrates the extent to which preference for larger carriers has tilted the playing field and substantiates the experience of Alaska Airlines.

In my personal opinion, unless the United States institutes a workable policy which is observed at an Administrative level, which would not set impediments, as I have discussed, for new entrants into limited entry international service, I personally don't see how new carriers can establish themselves. I see that the bias has, by far, greater implications than that which appears on the surface. It is not just that little Baltia has a problem here; I think it is a much larger problem. New carriers that intend to challenge larger carriers by offering greater public benefit do not have an op-

portunity to enter the market. If that type of situation persists, I believe that it will only aggravate the current situation, in which third country foreign carriers come in and take a piece of the U.S. international traffic.

I believe that it is very important to encourage new entrants and, in order to achieve that goal, there should be a level playing field for new and established carriers.

Thank you.

Mr. OBERSTAR. Thank you very much, Mr. Dmitrowsky. I raised this matter with Assistant Secretary Shane the other day in our hearing and drew a rather surprised response from him. It seemed almost as though he needed an introduction to Baltia Air Lines and was not aware that this was a new entrant that was being denied, quite the contrary of his grand policy pronouncements. His heart may be in the right place, but the decision of the Department didn't reflect that.

You cited a very pertinent part of that Administrative Law Judge decision that Baltia was, in the Judge's opinion, able to serve, but that another carrier is better able to serve. If you keep saying that, you will never get new people on the block.

Mr. DMITROWSKY. Well, actually the decision has not been made yet by the Department. I am only—

Mr. OBERSTAR. That's true, but that's the judgment that was passed up the line. If you apply that to the marketplace every time, the new secretary who applies for a job and hasn't worked before and is just out of secretarial school is never going to find employment, because employers are always looking for someone who has experience. Like Members of Congress, you get elected to Congress and no one questions you. You are fit, willing, and able the day you arrive here. Someone had to take a chance on each one of us—the voters—and they made a judgment. And the same ought to operate here. And while the comparison is not entirely apt, it is nonetheless striking. The Department is missing an opportunity here.

Mr. DMITROWSKY. If I may address one of the issues that I forgot.

Mr. OBERSTAR. Yes.

Mr. DMITROWSKY. I think that this goes beyond the immediate air service that we are discussing here. I think, purely out of necessity, Soviet negotiators had to afford certain rights to U.S. carriers because they are looking for transportation. I believe that this opportunity has to be seized now to the full extent. If we don't seize it now, there may be different times and the Soviet Union, itself, may change. A new bilateral, negotiated at some later date, may not be so advantageous as the one we already have.

Mr. OBERSTAR. Yes. That's true.

Mr. Sinick, I appreciated your observations about the CRS questions. Those are matters of great concern to members of this committee. We have addressed ourselves to them many times in the past. You put it very well that the smaller carriers in comparison to mega-carriers and to the two mega-CRS systems are, in effect, providing a revenue stream to those carriers, giving them greater financial capability to compete, again, with those smaller size carriers.

But I observed in our hearing the other day, and again today, that if I were managing a European carrier and looking for an

entry to the U.S. marketplace, I would be wanting to invest in significantly—and urge, in fact, the U.S. to change its ownership laws so that I could buy—a very strong, competitive regional carrier. Alaska Airlines would be a very good prospect. Has Alaska been approached by any foreign interests as an investment prospect?

Mr. SINICK. Not that I am aware of. I confess, they don't tell me everything, but I think I would probably be aware if they had, and I am not aware of any approaches.

Mr. OBERSTAR. Would the carrier be interested in any kind of investment that would be an arrangement similar to that which say, Northwest Airlines has with KLM, sharing aircraft and sharing cities?

Mr. SINICK. If the overall analysis was such that it would provide us with equipment and financing on more favorable terms than we could otherwise get, I doubt that we wouldn't be interested. I suspect we would be. We have not been, as I say, so approached. Right now the current philosophy—and I think you may know, Mr. Vecchi has recently become Chief Executive Officer after Mr. Kennedy, at the ripe old age of 52, decided to retire—is very much looking forward to a long run on an independent basis. We are quite pleased with our balance sheet. Certainly, it is not the equal of United's or an American's, but we have about \$1.5 billion of aircraft that will be delivered to us starting in the spring of 1992. We have our long-term agenda in terms of expansion. Yes—the gentleman next to me mentioned—it does include Siberia, which we are starting June 17th, but that is obviously a long-term gamble, as you might imagine it would be. And Canada, Mexico, and later Central America are very important to our plans.

And as observers of the scene, we read the Aviation Daily, we understand that probably in six to nine months we are going to see another massive route transfer. There are only approximately two left that we can envision. One would be the Pacific division, Continental's; and the other is Pan American's Latin American routes. Prospective buyers have already been identified, more or less, and—

Mr. OBERSTAR. Is Alaska among them?

Mr. SINICK. As of yet, no. Everything we read is that the prospective buyers are pretty much identified, as I say, and that's troubling to us. We have witnessed four major route transfers I think in the past five-and-a-half years at DOT. Basically, that has made those already dominant domestic carriers now dominant internationally. That's an awfully short period of time for that to have happened. It is not a case where they have won these routes in public interest proceedings where it has been determined that their proposal is the best; they are just fortunate to have the deepest pockets. That is kind of a long answer to your question, Mr. Chairman, but I don't want to rule anything out, I guess, as our President is fond of saying lately, or rule anything in, but I am sure as part of our obligation to our shareholders Alaska would have to carefully examine such a proposal.

Mr. OBERSTAR. I'll come back to the matter of route sales later. At this point, I recognize Ms. Molinari.

Ms. MOLINARI. Thank you, Mr. Chairman.

I am curious—our next panel is going to consist of representatives from the Flight Attendants industry. Unfortunately, I can't wait to hear their testimony. But with regard to the smaller carriers, I mean, clearly the industry is in such a state of flux that I would think that if I were someone that was embarking on a new career, particularly as a flight attendant, I would have a very difficult time in being persuaded to work for one of your carriers based on the lack of protection that currently exists. Are you finding that right now, is it difficult?

Mr. SINICK. My impression is to the contrary. We have hundreds, if not thousands, of employment applications from very well qualified people for every opening that we have. I think it is very much a buyers market for the most part. I know there was a shortage a couple of years ago I think in the machinist and mechanics area, skilled mechanics. There were a few shortages there, and it was also true in the pilot area. I frankly am not aware of whether those shortages have abated or not, but we do not lack for qualified applicants, thank goodness.

Ms. MOLINARI. Clearly, I am glad to hear that. It would just seem—

Mr. SINICK. But you do see situations where a job might open up at a mega-carrier, where if they are paying more, these are occasions where we are going to lose people. So you might say we incur training costs; we're kind of a farm team.

Ms. MOLINARI. I see. And I guess that makes—

Mr. SINICK. But we have a very, very I must say loyal, stable workforce, and that is a very significant part of Alaska's success. Those people that have flown on Alaska Airlines do remark to us that we seem to have a rather spirited and enjoyable workforce that makes the ride very pleasurable.

Ms. MOLINARI. And your experience is the same?

Mr. DMITROWSKY. We are not that far yet. But I don't see any problems in personnel.

Ms. MOLINARI. Thank you.

Mr. OBERSTAR. Mr. Clinger.

Mr. CLINGER. Thank you, Mr. Chairman. Gentlemen, thank you for your testimony.

Mr. Sinick, one of the things we hear about is the inability or the difficulty in a capital intensive industry at this stage of the game to find the capital. In other words, that we don't have capital formation capacity in this country to meet the needs that are emerging in the airline industry. Have you found that to be a problem in either one of your instances to get the necessary financing that you require?

Mr. SINICK. Your experience may be somewhat different than ours. We have not had any serious problems in that regard and I

would like to think it reflects our track record, and I suspect it does. I don't know how many carriers can point to 18 years of successive profitability. And we have financed a good portion of \$1.5 billion commitment that we're going to have to come up with.

Mr. CLINGER. You have got that pretty well in line?

Mr. SINICK. A good portion of it is, yes, that's right. We have an arrangement with ILFC, which purchased a special issue of Alaska's stock a couple of years ago which has helped that financing along also. Certainly, others have had it and we have no doubt that there were problems in terms of the weaker carriers finding financing. But, as I said before, I doubt very much that you are going to find the well-heeled European carrier or the well-heeled Pacific Rim carrier coming in to offer equity capital or debt capital to some of the shall we say weaker carriers in our industry. I would think they would have to look at the experience of SAS and scratch their head a little bit and say, now we saw what happened to their investment, which has virtually been lost. Are they going to replicate that situation? I tend to doubt it.

I really think that if we are not very careful, foreign investment liberalization could end up becoming another weapon, so to speak, in the hands of the very large carriers, who are likely to be the recipients of the foreign investment. That would make our lives just that much more difficult. We have to compete everyday. We understand we pay more for aircraft, we pay more for fuel, we pay more for insurance. That's fine. We overcome those challenges, but it is in areas of departmental inaction and policies where we think some little tweaks and corrections can be made, and we really would like to see that happen.

Mr. CLINGER. Yes, sir.

Mr. DMITROWSKY. Well, our case is somewhat different since Baltia is a start-up carrier. I would say that we have been able to secure financing, subject to receiving route authority.

Mr. CLINGER. Domestic financing?

Mr. DMITROWSKY. Domestic, yes. I personally find that the largest difficulty for any U.S. airline to overcome in obtaining domestic capital is the poor impression that financial markets have of the industry as a whole. Actually, it may not be necessarily so that financing a new carrier is more risky now than it was before. In fact, I think it is less risky. A new start-up carrier like Baltia has greater opportunities and chances of success than if there were many carriers or if the major U.S. carriers were very strong. So, in that respect, the current conditions create a certain advantage. But, certainly, financial markets have to be enlightened of that fact.

Also, a very significant element in securing capital is route authority. Indeed, we thought that the biggest obstacle in creating a new airline was financing. But, actually, I believe at this point that securing the necessary route authority in an international market may be the ultimate test.

Mr. CLINGER. More of a critical element.

If either one of you were in a position today to change policy and have one single thing that you could do to change that policy, what would it be? What would you give the highest priority to? What do you think needs to be changed?

Mr. DMITROWSKY. I could say simply, a level playing field would be all that is required. The tilt should not be extraordinarily heavy in favor of the larger carriers. I understand that some protection may be needed for large carriers, but there should be a certain balance between new and established carriers where the value of new entrants should be weighed against the interests of—

Mr. CLINGER. Which you don't think it now is? In other words, the fact that it is a new competing airline is not really given consideration by the Department of Transportation?

Mr. DMITROWSKY. No. My impression is that it is larger carriers at all cost or at any cost.

Mr. CLINGER. Mr. Sinick?

Mr. SINICK. We feel quite strongly as well about the carrier selection policy. There is a tenet in the statute about trying to foster new entrants that was put in 1978 when the Deregulation Act was passed. I must say it was followed to some extent in the early years of deregulation, but it really seems to have been a tenet that's gathered a lot of dust lately. Something should be in there regarding the number of ways to do this. It would essentially require the Department to make a prima facie case showing that your proposal is credible. But a lot of weight should be accorded to your proposal when you are one of the smaller major or national carriers or even a carrier the size of Baltia which is just a paper carrier at this point. That is quite important and I think it would send a terrific signal. We haven't seen any People Expresses and we haven't seen a lot of new entrant carriers, and there are reasons for that.

As we sit and observe; there is obviously going to be a fascinating route contest over Baltimore and Philadelphia. Is it going to go to one of the smaller major or national carriers or is it going to go to one of the mega-carriers, assuming it is a contested proceeding, and I gather that very much remains to be seen. What is going to happen to Pittsburgh/Manchester versus Atlanta/Manchester? Again, the proof is in the pudding and, unfortunately, the results we have observed show that it has been pretty much a one-sided arrangement for quite some time and we think it is unfortunate and not necessary.

Mr. CLINGER. Thank you gentlemen.

Mr. SINICK. But CRS is also very important. I am going to die saying that. [Laughter.]

Mr. OBERSTAR. We understand that. Let's hope that we will be able to do something with that subject.

What should be the role of experience in the judgment of those who make route awards, and even when there are route sales? Should it be fit, willing, able and experienced? I am not suggesting,

I am just saying it seems that that's what the Department has done. They have parenthetically amended the traditional concept—fit, willing, able, and experienced.

What I am trying to get at is if we're going to have real competition and we have only so many carriers and the number is being reduced consistently, then how do you sustain competition if you don't have new people coming into the field and if the departmental judgement in route awards is going to be based on a factor that in its very definition means you can't come in because they are not experienced.

Mr. DMITROWSKY. Well then it should be stated so. But if a new carrier follows the rules that the department establishes for competition and if it prevails on the merits, and then it receives only a back-up recommendation because it is a new carrier, then I think that is not following the rules that the Department itself has set.

Mr. OBERSTAR. Now we have a very truly new entrant carrier, Baltia, and if Alaska were to bid on that Soviet service or to have bid on one of the London routes, it would be in effect in that market a new entrant but with some experience. What are your views about that matter?

Mr. SINICK. First of all, I want to make it clear that Alaska Airlines has not participated in any of the route transfers that have taken place. But we have certainly observed, Mr. Chairman, that there have been other carriers, who are not the deep-pocket purchasers, who have asked to serve one or two city pairs, and, indeed, serve them better than the purchaser of the whole package. With the exception of the Philadelphia-Baltimore example, in which I would say the ink is really not dry yet, the Department had followed a policy where it would not start to look at pieces—city pair by city pair—on a kind of public interest basis and consider competing applications.

If that policy were changed, I think you would see the smaller carriers far better positioned to say, okay, with respect to a piece of it, I can do a better job than can the purchaser of the whole. And that policy has been a significant barrier, shall we say, to the smaller carriers' ability to try and acquire a piece of what is otherwise a major route transfer. Delta tried for a L.A.-London spin-off and nothing has taken place so far. Whether the Philadelphia-Baltimore situation signals a change in policy, I am frankly not certain.

Mr. OBERSTAR. I am going to have to interrupt at this point. We are down to the last few minutes on a recorded vote on the House Floor. We will take a brief recess.

I want to thank you very, very much for being with us and for your very thoughtful contributions. I wish we had more time to explore more of these matters. But we will continue to seek your input as we proceed.

[Mr. Sinick's prepared statement appears on page 385.]

[Mr. Dmitrowsky's prepared statement appears on page 259.]

[Recess.]

Mr. OBERSTAR. The committee will come to order.

We will now proceed with the patient Mr. Brian Moreau, president of the Independent Union of Flight Attendants. We apologize for the frequent interruptions. Those are the hazards of our duty, far less of a hazard than the hazards of the duty of your members. We welcome your presentation and look forward to your testimony. Please don't feel that you need to rush because it is nearing 5:00. I assure you the Chair will extend the fullest attention to this testimony, as to the preceding.

TESTIMONY OF BRIAN MOREAU, PRESIDENT, INDEPENDENT UNION OF FLIGHT ATTENDANTS

Mr. MOREAU. Thank you, Mr. Chairman. My name is Brian Moreau. I am the president of the Independent Union of Flight Attendants and I am here testifying on behalf of the 30,000 flight attendants at American, Pan Am, and TWA. Thank you for the opportunity to testify. I would like to respond to the committee's questions with an ear toward the effects that international events are having on the employees of U.S. carriers.

Over the next few years, the consolidation of the industry will continue. Eastern is gone. Pan Am, operating day-to-day under the protection of Chapter 11 bankruptcy protection, is hanging on by a thread. Continental is also in bankruptcy. The chairman of TWA has threatened the same for that carrier. Midway is under severe pressure.

In its struggle to survive, Eastern sold its Latin American routes to American Airlines. Pan Am is surviving today solely as a result of major asset sales. Along with its non-airline subsidiaries, it has sold its inter-German airline division to Lufthansa and its Pacific and Heathrow route authority to United. The Pan Am Shuttle is on the auction block. Many analysts believe that Pan Am is biding its time until it can sell its Latin American division or its Frankfurt or New York operations. TWA wants to sell its Heathrow routes to American. Continental has sold its Seattle to Tokyo flights to America. It is reasonable to believe that these asset sales will stop only when there are three or four airlines left.

It is the employees of these carriers who struggle in the wake of these corporate wheeling and dealings. Of the approximately 700 to 900 flight attendants required to fly Pan Am's Heathrow operation, only slightly more than 250 have been offered transfer with the routes to United. No United States-based TWA or Continental employees are being offered employment with American. No United States-based Eastern employees were transferred with the sale of their Latin American division.

Not so with foreign employees. American took all of Eastern's Latin American employees and is taking TWA's British employees. United took all of Pan Am's foreign employees in the Pacific sale and most in the Heathrow sale. In case after case, the foreign employees, protected by their governments, are offered jobs. U.S.-based employees are offered the streets.

This trend will continue. The acquiring carriers want new-hire entry level employees, not seasoned veterans. And why not? A new hire flight attendant at United, on the B-Scale, is paid \$1,039 base pay per month. A 20-year Pan Am flight attendant is paid \$2,128. Multiply the difference by the 900 or so jobs at stake for flight attendants alone and you can see that the acquiring carriers are financing their acquisitions off the backs of the very employees who have worked so diligently over the years to make the routes prosper.

One issue has been entirely consistent throughout all asset sales—the DOT routinely dismisses labor protective provisions, stating time and time again that protection over route sales must be bargained for. That means very little to the Pan Am employees who bargained for severance pay in the Pacific sale to United, who after a three-year arbitration, won their severance pay issues only to find out that these payments will not now be made because of Pan Am's bankruptcy. It means little to the flight attendants in London who were not offered transfer to United, even though that right was bargained for.

Employees are caught in a "Catch 22." The DOT tells us, the unions, to bargain job protections with our carriers. We do. The carrier then sells routes or assets, without the bargained-for protections. The unions move to implement the protections, only to be told by the acquiring carrier that it had no legal obligation to be bound by the bargained-for protections. And the courts back that position. The only gain enforceable in courts from these negotiations appear to be severance pay for displaced employees. And as stated earlier, a bankrupt carrier, such as Pan Am, is likely not to pay that. TWA, a carrier not in bankruptcy, is denying its 1,200 recently furloughed flight attendants any severance pay.

Airline workers aren't looking for severance pay. We are looking for a job, for gainful employment. With L.P.P.'s, employees can be denied any rights as a result of a route sale. The Congress should mandate that the Department of Transportation issue appropriate labor protective provisions in every merger or acquisition.

The issue of aviation security is another area of discriminatory practice between U.S. employees and foreign nationals. The Aviation Security Act on which this committee worked so diligently last session of Congress, provides for criminal background security checks of U.S. aviation employees who have access to secured areas at U.S. airports. Every indication from the FAA shows that foreign national crew members will not be held to this same test even though they may have access to U.S. airport secured areas. It has been predicted that any attempts to hold foreign nationals to the same standard will run into similar problems as experienced with the drug testing of foreign nationals, which has yet to become effective.

These problems stem from complicated bilateral agreements between foreign countries that must be negotiated. Some foreign countries will not legally allow employees to be subjected to such personal intrusion. U.S. air carriers are forced to foot the bill in the large financial costs to comply with the U.S. requirements for drug testing and background checks. In looking to the future and to a global economy, foreign national crew members and foreign

carriers should be held to the same standards as U.S. employees in U.S. air carriers.

On the financial front, another issue to be debated is increased foreign ownership in U.S. carriers. As a matter of principle, employees of U.S. carriers would oppose substantial foreign investment. We have enough trouble negotiating with managements in our city, State, or country. The difficulties of working for unseen and unknown entities across the pond can only be imagined. For example, had the Shah of Iran completed his purchase of 25 percent of Pan Am in the early 1970's, the United States could have found itself in a very sticky situation when Iran was holding U.S. citizens as hostages.

But given all the inherent problems, airline employees would unerringly choose increased foreign ownership over the liquidation of their carrier and the loss of their jobs. But foreign carriers should not be allowed to effectively buy cabotage rights through a significant investment in U.S. carriers.

Quite possibly, cabotage will be the most widely debated issue of the next two years. Our concern on this issue was heightened only a few months when Open Skies talks with Canada were announced. In view of the current free trade talks with Mexico, the three independent flight attendant unions, on whose behalf I am testifying today, must stand firmly opposed to all forms of cabotage. We all know that current Mexican wages drastically undercut wages of U.S. employees. But just as important are the many problems associated with safety that will arise. Who will set the safety standards? Which agency will be responsible for oversight?

In an earlier hearing before this committee, the panel was asked if a form of reciprocal cabotage would be acceptable to U.S. flight crews—for example, U.S. crews working all flights of a Canadian carriers operating within Canada; and, in the opposite, Canadian workers operating on U.S. carriers between Canadian points. While that concept cannot be dismissed out of hand, some important issues should be considered.

First, the foreign carrier operating in the U.S. would hire entry level workers at new-hire pay rates. That, of course, would continue the pressure on incumbent U.S. carriers to lower their wage rates to match those lower levels. The effects may be subtle, but they will be real.

Secondly, how does such a reciprocity work for incumbent U.S. carriers with an established work force? Pan Am and TWA have a substantial foreign presence. Will our current flight crews be displaced because a foreign government insists that its nationals operate on certain foreign sectors? We fear that any protection offered by the reciprocity provisions would only be paper protections. We ask this Congress to say no to cabotage.

And if the airline industry is becoming global, then U.S. labor must also be allowed to globalize. I would like to bring to the attention of this committee a new issue that must be addressed. A recent United States Court of Appeals decision effectively removed the right of U.S. labor union to negotiate enforceable contract provisions for foreign point to foreign point flying. The court ruled that disputes arising from agreements made under the provisions of the Railway Labor Act could not be arbitrated if the dispute in-

volved totally foreign flying. It stated, in part, that the Congress never intended for the Railway Labor Act to apply to such flying.

For a workforce like Pan Am's or TWA's, which have performed extensive foreign flying, to be told after 60 years by the courts that our negotiated contracts are unenforceable is startling. And contract provisions negotiated by the "new kids on the block"—American and United—are only as good as the intentions of those carriers. parts of the agreements cannot be arbitrated or enforced.

This is especially distressing in that many carriers are now employing foreign national flight attendants. Each union has negotiated with its carriers to limit the number of foreign nationals. If this court decision stands, some of those protections may be gutted. We believe that the Circuit Court decision is wrong and we hope that the Supreme Court will make the right decision. But that not being the case, we will ask this Congress to quickly pass legislation that reestablishes the rights of labor unions to make agreements and resolve disputes under the Railway Labor Act—not just agreements that apply within the United States or on sectors that originate or end in a U.S. city, but world-wide enforceable agreements.

Our unions understand that the world is changing. Most assuredly, we will adamantly oppose some of these changes that can substantially harm the people we represent. But change will come—for good or bad. Labor must be allowed to change with the times. We must no longer be prohibited from competing in the world marketplace. We must be allowed what other worldwide unions take for granted—not allowing the permanent replacement of strikers.

If there is to be a new level of global competition, give labor the right to compete as well. Let there be competition of ideas. Give U.S. labor unions the right to fully represent our members in flying overseas and to reach out and organize the foreign workers that crew our aircraft.

Today, the laws of our country effectively prevent such representation. We ask Congress to level the playing field. Amend the Railway Labor Act to explicitly bring foreign point to foreign point flying within the coverage of the Railway Labor Act, and to allow for foreign crew members working for U.S. carriers, with their consent and the consent of their governments, to be represented by U.S. labor unions.

We stress again that U.S. employees should be afforded the same rights as foreign workers. U.S. employees should be protected in the event of the sale of routes or other assets.

Once again, I appreciate the opportunity to testify here today. Thank you.

Mr. OBERSTAR. Thank you very much, Mr. Moreau. You raise a number of very important issues for our consideration in the international aviation policy arena, particularly the impact upon those at the action level, those who are on the firing line—the employees of the carriers—and the unique problems facing them in these route transfers. You have taken the theoretical and the ethereal out of the stratosphere and brought it down to the real world, the pavement level here.

With respect to the most recent case at hand, the sale of the Pan Am and TWA London routes, did your union take a position on those sales?

Mr. MOREAU. The IUFA, representing Pan Am, did not take a position. I believe that the Independent Federation of Flight Attendants, representing TWA employees, did take a position opposing those route sales.

Mr. OBERSTAR. They were opposed for many of the reasons you expressed in your testimony. Let's suppose for a moment that these were European carriers, that theoretically this were Air France buying up international routes that UTA was operating, what would have been the commensurate position of flight attendants for UTA in such an acquisition by Air France?

Mr. MOREAU. If I understand the question, if it would happen in France the way it is happening in the U.S., the UTA flight attendants would not be employed, they would be out of work. If you flip the question over, back to the real world, Lufthansa did buy Pan Am's Berlin international route authority. The German government required that all flight attendants, in fact all German employees of Pan Am, be offered employment with Lufthansa.

Mr. OBERSTAR. So, I was going to move next to a very different situation, you anticipated by thought process. German law is more protective of employees in the airline industry than let's say French law is?

Mr. MOREAU. I am not familiar with the French law. I don't know.

Mr. OBERSTAR. But if you say that UTA employees would not have been protected.

Mr. MOREAU. No, I said if it happened in France the way it is happening the way in the United States.

Mr. OBERSTAR. Oh, yes. You don't know the French law then?

Mr. MOREAU. No, I don't know.

Mr. OBERSTAR. Oh, I'm sorry. Okay. But in the case of Germany, even the Pan Am employees were protected there. In that case, there were a significant number, maybe all of them, German nationals?

Mr. MOREAU. Or EC members, yes.

Mr. OBERSTAR. Much more humane way of dealing with these matters than in the case of the U.S. carrier acquisitions. I think there are similar problems with the Latin America routes that American has acquired.

You raise the question of the Railway Labor Act and the court case about point-to-point flying. Would you want to expand upon that issue and the rationale the court used in reaching its decision.

Mr. MOREAU. Our union has a contract with Pan Am that states that all flying for Pan Am will be performed by the members of our union. We carved out two exceptions; we carved out the internal German service, which would allow the German nationals to operate, and 300 work position for foreign national employees in various cities around the world. We had a work dispute over international foreign flying that our contract says belongs to our bargaining unit. We arbitrated. The company refused to arbitrate. We went to court to compel arbitration. The court ruled that since the flying in question was entirely outside the United States, that there was no enforcement mechanism available to us. So we have not been able to arbitrate the dispute and the court will not rule on it.

Mr. OBERSTAR. There is a prevailing view both within the industry and among observers of the industry and, to some extent, within the Department of Transportation that foreign investment is the answer to the industry's problems; that investment by either foreign carriers or other foreign investors can save U.S. airlines. What is your view of that?

Mr. MOREAU. I think that good management will save U.S. airlines. Foreign entity or foreign concern is probably not willing to invest in poorly run airlines and, as we've heard here earlier today, they would more likely than not invest in well run airlines, those that are making a profit. They are not giving away money, they are investing; they want a return on that investment. So I think that in the short-term at least, from the perspective of Pan Am and perhaps from TWA, foreign investment is not necessarily—I don't expect that.

Mr. OBERSTAR. Thank you. I have a great deal of skepticism about that myself.

At this point, the Chair will recognize the gentleman from Pennsylvania, Mr. Clinger.

Mr. CLINGER. Thank you, Mr. Chairman. Thank you, Mr. Moreau for your testimony.

You do indicate that whereas you feel that foreign investment and foreign ownership is not a good idea, but, nevertheless, would agree that if it were a question of survival, in that event you would opt on the side of allowing the foreign investment. Is that correct?

Mr. MOREAU. That is correct, yes.

Mr. CLINGER. As I say, at the moment the whole issue may be somewhat moot because nobody seems to be rushing forward to offer money to any of our airlines.

Okay. I don't think I have any further questions.

Mr. OBERSTAR. Thank you.

Mr. Rahall?

Mr. RAHALL. Thank you, Mr. Chairman.

Mr. Moreau, you spoke very well in your testimony about the effect upon employees when these acquisitions occur and when airlines are bought out. You have explained the Catch 22 situation in which many employees find themselves. There is a human side to this and it does occur very often, as I am sure you are well aware and all of your employees are aware, with not only airline flight attendants but pilots, baggage handlers, on down the line.

In last week's Washington Post, it carried a story about a West Virginian, a native son from my home State, by the name of Danny Heater. As a lad of 17 from a small coal mining town of Burnsville in Braxton County, West Virginia, Danny made sports history by setting an all-time record of 135 total points scored in a single high school basketball game. This story was in Post and it goes on to tell how Danny left his very humble beginnings in West Virginia, moved to Washington, DC. At the age of 24 he went to work as a baggage handler at National Airport. Today, 25 years later, he is working for Pan Am as a customer service agent here at National Airport. The sad news, of course, which we all know, is that Danny's airline, once a pioneer in worldwide aviation, is not expected to stay in business much longer. Other carriers are expected to move in and buy out Pan Am's international routes,

you've talked about that in your testimony, the shuttle, other assets, et cetera. The long-time employees like Danny Heater—pilots, flight attendants, mechanics, passenger agents, reservationists, and so forth—are all going to be left high and dry.

In your testimony you did say that the U.S. Government has a responsibility here, that Congress should mandate that it is in the public policy of this Government to ensure that jobs are transferred with assets. So I guess my question is, and certainly I can understand and sympathize with that position, but should the acquiring airline then be mandated to provide pay provisions, severance pay, or what type of provisions should they provide for those laid-off employees or for the affected employees who may or may not be laid off?

Mr. MOREAU. Currently, it is the airline that the employee works for that is required to pay severance pay. If a route is sold and someone loses their job, which happened to us in San Francisco, then it would be Pan Am's responsibility to pay. But the carrier would be receiving generally a large sum of money from the sale of those assets and I think it would be appropriate that a small portion—and it would be a very small portion—of that money be set aside to provide for appropriate severance pay for the employees. And whether it comes through the mechanism of the carrier that is currently the employer or the acquiring carrier, that to my members would be irrelevant as long as there is a provision.

But my members and the airline community, we're not, again, looking for severance pay. We want our jobs.

Mr. RAHALL. I understand.

Mr. MOREAU. To bring it to just the level of Mr. Heater at Washington National Airport and employees similarly situated, they have their very own Catch 22. The Pan Am Shuttle is up for sale and that is the majority of the work of Pan Am at National Airport. If the Shuttle isn't sold, Pan Am may fail as an entity in that they must have that cash. But if they do sell it and there is no job protection for Mr. Heater or for other similarly situated employees, he may lose his job anyway. So it is a tough road for us all, and in some specific locations, like at Washington National, even the survival of Pan Am without appropriate job protections may mean the end of some of our employment.

Mr. RAHALL. Do you think we have the responsibility in Congress to require that these type of clauses be inserted in these agreements?

Mr. MOREAU. I think you do. And I think you do because the airlines aren't out making widgets, they are selling public assets—routes, gates, slots—that are devised by Government actions, bilateral agreements that the Government controls. The Government could as easily tell the airline that there is no residual value to that route and could award it on a fitness basis to another carrier. By allowing the carriers to sell public assets, I believe that the Congress has an obligation to the employees that service those public assets.

Mr. RAHALL. Thank you. Thank you, Mr. Chairman.

Mr. OBERSTAR. Yes, what we have is the unenviable specter of ailing airlines selling off assets, as you said—routes, gates, slots,

aircraft—until all that's left is, as in *Alice in Wonderland*, the smile of the Cheshire cat—no employees, equipment, just the name.

Mr. MOREAU. And a lot of debt.

Mr. OBERSTAR. It really is—by raising this question, how much foreign investment are you, speaking for your members, willing to accept in order to save, if it will save, a financially ailing carrier?

Mr. MOREAU. We think that the 25 percent level is reasonable, the 49 percent level would be acceptable, and——

Mr. OBERSTAR. Which 49 percent level?

Mr. MOREAU. Oh, ownership.

Mr. OBERSTAR. As expressed by Mr. Skinner in the Northwest Airlines case or stock ownership, as I believe is expressed in Mr. Clinger's bill?

Mr. MOREAU. To be actually—for our membership, for the particular membership of Pan Am, probably 100 percent foreign ownership would be acceptable. [Laughter.]

For some of the other carriers and some of the other unions, American and TWA, I think that probably based on their particular circumstances, the unions at American would accept less, the unions at TWA perhaps less or somewhere in-between. We're coming down to accepting foreign ownership as a lesser of evils. We actually had some employees, actually quite a few employees, who expressed a desire to move to Berlin to work for Lufthansa if they could have had those positions. So we are down to the position of making hard choices to preserve jobs.

Mr. OBERSTAR. If changing the ownership rules above 50 percent were to result in allowing—which would be the fact—allowing a foreign carrier to operate in the U.S., flying point-to-point, moving U.S. passengers from point-to-point, do you have any concerns that this might result in loss of positions, loss of American jobs, that it might mean the substitution of—if the acquirer were a foreign carrier—substitution of foreign nationals for American workers in the various positions of pilot, flight attendant, machinist?

Mr. MOREAU. We have great concern over those issues. That is one of our major concerns as far as cabotage. As I heard here earlier, foreign investment and cabotage are really different sides of the same coin. That would be the major concern for the flight attendants that we represent. And for the TWA and the Pan Am employees, including American now that they are becoming larger in the international arena, if a bilateral agreement or an agreement that required foreign carriers to use American workers or U.S. workers in the United States were reached, with a unified Europe coming in the future, perhaps we could find that we no longer could fly between London and Frankfurt or London and Paris and that those would have to go to EC nationals. We could end up losing the jobs that we already have or trading them off in certain areas. Those are concerns.

Mr. OBERSTAR. Is there a foreign carrier interested in acquiring Pan Am to your knowledge?

Mr. MOREAU. I think that there are quite a few foreign carriers that would be interested. I am not aware of any carrier that is willing or able at this time to put forward the financing that would be required to do it. There have been discussions between Pan Am

management and a variety of airlines, both U.S. and international, and none of those have come forward.

Mr. OBERSTAR. The DOT decision on the London routes has the effect of stating a policy that the Department is going to substitute strong carriers for weak carriers. Is that a judgement that ought to be made? Will that strengthen overall U.S. airline competitive position abroad, having fewer but bigger carriers?

Mr. MOREAU. In the long-run, I can't see how that is possible. I can't see how in the Pan Am case, for instance, as far as competition is concerned, how having United on the New York route versus Delta on the Los Angeles-London route, how in the long-run that wouldn't have been better for competition. But I don't know that I can judge that. We have a decision and we just have to live with it.

Mr. OBERSTAR. All of these trade relations are give-and-take negotiations. One very significant trade-off is cabotage for U.S. carriers within the post-1992 Europe in exchange for cabotage for European carriers within the U.S. market. Do you think that's a fair trade-off?

Mr. MOREAU. Actually, I don't. I think that the U.S. market is so large and such a dynamic market that the carriers would be able to come into the United States offering limited service in certain specific markets, take the cream of the market, if you will, and that the U.S. carriers that would be operating in Europe between say London and Paris couldn't necessarily compete in those markets for a variety of reasons, including language and name recognition, if you will.

The Europeans for so many years have been use to American and TWA and American carriers in European markets. But if some United States citizen has the opportunity to fly from Atlanta to Dallas perhaps on Lufthansa, they might just feel that is an experience, if you will, and try it. I don't see that in the long-run that the markets are equal, and I think that U.S. carriers will get the short end of that stick.

Mr. OBERSTAR. Those are the policy considerations that the Department has to be thinking very careful about. Carriers certainly don't look at the broad implications for the travelling public, for the communities in the U.S. that they serve when they are selling their international routes. They are looking to satisfy creditors or to keep the carrier, even if it is only the name, afloat. Your concern, rightly and properly and appropriately, is for the future of your members. We will continue to work with you to achieve measures of equity to the extent that we can, both in the negotiating process and in whatever legislation we may be able to fashion to deal with this very troubling aspect and chapter of American aviation.

Thank you very much for being with us.

Mr. MOREAU. Thank you.

[Mr. Moreau's prepared statement appears on page 375.]

Mr. OBERSTAR. The subcommittee will pursue this inquiry further with additional hearings in later April or early May. Until then, we shall adjourn this chapter of our hearing.

[Whereupon, at 5:25 p.m., the subcommittee adjourned, to reconvene at the call of the Chair.]



PREPARED STATEMENTS OF WITNESSES

BEFORE THE
CONGRESS OF THE UNITED STATES
SUBCOMMITTEE ON AVIATION

TESTIMONY OF
IGOR DMITROWSKY, PRESIDENT & CHIEF EXECUTIVE OFFICER OF
BALTIA AIR LINES, INC.

U.S. INTERNATIONAL AVIATION IN TEN YEARS

Introduction

My name is Igor Dmitrowsky. I am the President and Chief Executive Officer of Baltia Air Lines, Inc. (Baltia), which is proposing to start international service between the U.S. and the U.S.S.R, a limited entry market created by the recent U.S.-U.S.S.R Civil Transport Agreement to be effective April of this year.

I realize many of you may not have heard of "BALTIA AIR LINES." By way of background, Baltia is a New York corporation formed in 1989 for the purpose of creating and establishing a new air carrier. This January, 1991, the Department of Transportation (DOT) tentatively found Baltia to be a U.S. citizen, fit, willing, and able to provide international service, in accordance with its business plan and operating proposal to provide five non-stop round-trip flights per week between New York and Leningrad, and between New York and Riga with Boeing 767-200ER; providing service beyond Riga to Kiev, Minsk, Tbilisi and Moscow with B737-200. (ORDER TO SHOW CAUSE - DOT Order 91-1-65) in order to obtain the right to provide this service, we are currently one of five remaining applicants in the route proceeding to select U.S. carriers to serve the Soviet Union market. This selection decision is now pending before the DOT.

I am here today to present the views of a new carrier, attempting to start-up operations in an industry which is experiencing substantial problems, carriers selling routes or going out of business. It is difficult to create a new airline in an industry that has not seen a single new applicant since 1989, or an new international applicant since 1983. But the general difficulties the airline industry is experiencing, in a true free market economy, represents opportunity for a start-up company like Baltia. This, I hope, is the strength of the U.S. free market economy, and the perspective I wish to share with you. The U.S.

Testimony of I. Dmitrowsky (REV.1) - page 1

needs new U.S. companies and businesses to obtain real competition. But starting up in the airline business is particularly difficult. Unfortunately, the playing field is not level for a start-up airline. I hope that the sharing of my experiences and perspectives will assist you in preserving a competitive environment in the U.S. air transportation industry. Start-ups, such as Baltia, need active encouragement, and without new carriers, the U.S. just won't be able to effectively compete with foreign carriers. With your indulgence, I will use examples from Baltia's actual experience in seeking financing and authority to start operations.

Issue Addressed

My testimony focuses on an issue that has relevance to the future of the U.S. airline industry in the international environment, well beyond the specific interests of Baltia, or the immediate concerns for the ailing industry. It is whether new U.S. carriers can effectively compete for limited entry international service, or if such opportunities are exclusively reserved for the benefit of established carriers.

My premise is that if the United States wants to be a viable international aviation force in ten years, it needs a present policy which encourages new airlines in international service. If the policy is to award all primary international route authority to established carriers, the United States may effectively prohibit new carriers, which need the financial opportunities represented by international air commerce agreements.

Airlines Are Not Immortal

Aristotle, believed that everything in life came to pass; only the stars in the heavens were eternal and never changing. But stars have a life cycle too - they are born, live through maturity and die. Some are big, some are small, some are pulsating, while others are stable. Some live long, others don't. At the end of their life, some fizzle out uneventfully, some become red giants clinging on for a while longer, others die violently; quite a few are swallowed by their companions. And elsewhere, from the particles of dust, matter is congealing to form new stars -- new airlines.

It may be difficult to accept that we live in a dynamic world. We knew that stars were changing, but the discovery that certain airlines may not be eternal was a disappointment to most everybody. Airlines like Pan Am bring many memories. Myself, more than fifteen years ago, as a young emigrant, I flew to the U.S.A on Pan Am.

Not too long ago, it seemed that carriers like Pan American and TWA had the world all to themselves. Today, Pan American has financial difficulties, and it is American Airlines and United that look strong. But who can say that in time American or United might not also change?

To compete more effectively with international carriers, a large carrier like American might argue that it needs more latitude, and less international competition from U.S. airlines. If so, would American like to become the largest airline in the world - like Aeroflot? Nothing could be more dangerous than to promote an oligopoly. Certainly, oligopoly should not be deliberately promoted, especially not at the expense of new airlines, because without the birth of new U.S. airlines the industry will go further in a decline.

NEW CARRIERS ARE NEEDED

New Carriers Challenge Existing Carrier Practices

Without new carriers challenging existing practices, society loses the driving energy behind new development and exploration.

For example, negotiators for the U.S. obtained important air transportation rights to enter parts of the Soviet Union which have not had U.S. carrier service from the United States. These new areas represent a catchment area for air commerce including a population more than one-half the size of the entire United States, in particular, the Baltic States (including Leningrad), the Ukraine, Byelorussia, and Soviet Georgia. However, in response to this historic opportunity, existing international scheduled carriers have argued that only Moscow warrants substantial service. Baltia was the only applicant to propose a workable and competitive service proposal to the non-Moscow cities, opened up for the first time in new bilateral with the U.S.S.R.

The U.S. airline industry may still be paying a price for having been regulated more than ten years ago. Similarly, the Soviet Union is definitely paying for having an economy of state run enterprises. I would call it "the syndrome of unchallenged giants." U.S. international airlines that grow without being continuously challenged by U.S. competition, sooner or later become inefficient, lethargic and vulnerable to foreign competitors. They suffer from their own weight.

There may be occasions when help is warranted for a giant carrier, but to attain a healthy balance, the U.S. should not dwell solely on its ailing airlines by putting all the eggs, *ie.* route authorities, in the basket of the big carriers. An airline such as Baltia may be better able to compete by being focused, professional, lean, efficient, highly responsive to the market needs.

At this point in time, with the attrition of carriers, to obtain a balance, it would seem safer to experiment with permitting more rather than fewer new carriers in the international market. The notion that only a large carrier can succeed, competing simultaneously in all international and domestic markets is both dangerous, and not in keeping with the basic philosophy of the American dream.

Finnair Contradicts the Large Carrier Theory

Presently, the U.S.-U.S.S.R market is dominated by foreign carriers: Finnair, SAS, Lufthansa, British Airways, Air France, LOT, JAT. Foreign carriers serve 80% of the U.S.-U.S.S.R market. Of all the carriers, Finnair is the most dominant in the market. One of the witnesses in the U.S.-U.S.S.R route proceedings stated, "Finnair is eating them [Pan Am] up." However, Finland is a country with a population of just eight million. Finnair is surviving and succeeding through its ability to best serve a focused international market, carrying U.S. passengers more efficiently and conveniently than U.S. international carriers. Why? Because Finnair is able to use the international air commerce rights negotiated for in an effective and competitive manner. Currently Finnair is negotiating with the U.S.S.R and Japan for direct flights Tokyo-Helsinki over Soviet territory.

Need for Aggressive New Carriers

Of necessity, for survival, a small carrier must be more aggressive and opportunistic than established companies. For example, Baltia sees the U.S.-U.S.S.R. air traffic as a substantial U.S. resource that has been lost to foreign carriers, and is seeking to recapture the market by a strong and aggressive proposal, that uses those features within the negotiated Bilateral agreement to maximum advantage, to obtain a competitive advantage over foreign carriers, who must rely on their own negotiated agreements.

It is a real danger that through the misguided policies based on fear and doubt, the U.S. government will be more concerned to protect established carriers to the detriment of the public use of privileges obtained during bilateral negotiations. As a result, we end up in a game the United States of America just isn't suited for: government protectionism of big international companies. The American way is to promote competition and innovation, and to hazard creativity and daring.

DIFFICULTY OF NEW ENTRANT

Baltia is the only new airline seeking to start-up in the U.S. since North American entered domestic service in 1989, and since Tower Air entered international service in 1983. This, coupled with the severe attrition of companies, should be a danger sign that competition is at risk in the airline industry.

Financial Markets Need Assurance

One reason why Baltia has been able to interest investors, pending route authority, is because it has applied for a limited entry authority in a unique international niche market, with enormous growth potential, the U.S.-U.S.S.R. To Baltia's investors, this designation offers a degree of protection during start up. Financing is only one of the difficult hurdles for a new carrier; government policy can create an impossible impediment.

Experience of Personnel Often not Enough: A New Carrier is No Good

The attitude exists that a new carrier is not good. To draw an analogy with the auto industry, one might say that Detroit had long experience building cars and therefore, when Japanese manufacturers came along, they were not good.

For example, Baltia has been able to assemble senior management with combined experience of more than 150 years with leading U.S. airlines, and qualifications which are quite substantial, and more than adequate for a normal fitness proceeding. Yet, a new airline such as Baltia is criticised for its lack of operating experience. The paradox of this situation was well stated by the Administrative Law Judge in the current U.S.-U.S.S.R route proceeding who wrote in part:

I agree with Baltia's assertion that although fitness is not an issue in this proceeding, in fact, some parties have relied on fitness issues not germane to the proceeding in arguing that Baltia should not be selected. I am assuming that Baltia is fit, willing and able to operate its proposed routes and that it has the managerial skills and technical ability to conduct its proposed service. Indeed, the Department has tentatively so concluded. I do question whether Baltia can operate a U.S.-U.S.S.R. route as well as an experienced, established carrier like TWA. That does not mean Baltia is unable to do so; only that TWA is better able to do so. (Order Served February 19, 1991, p.39, n.38).

Consequently, policy which favors the operating experience of a company, measured by how long it has been in existence, and ignores the experience of its people, may completely prevent a new airline from competing. This is one of the subtle, but truly substantial impediments which Baltia has to face in seeking favorable treatment from governmental agencies.

The problem is that the merits of a start-up carriers' proposal or its personnel may not be considered, if the choice is between a start-up and an existing carrier. The Judge quoted above admitted that Baltia's service proposal provided more, better service to

more cities but discarded its relevance, commenting that, "Little experience is better than none."

The problem for a new carrier is that the financial market is extremely sensitive to attitudes and policies expressed by governmental officials, particularly in an industry such as international air commerce, where the right to exist depends upon government selection and approval. Although Baltia expects to be selected to operate its service proposal, there are strong forces working against start-up carriers, and extra effort must be made by those in government to assist in maintaining a competitive environment. Without the diversity and creativity represented by new carriers such as Baltia, important opportunities can be easily overlooked, such as those negotiated in the recent Soviet bilateral.

If Baltia is not selected in the current selection proceeding, which is possible, I think it will be because the involved policymakers are fearful of change, that it is better to stick with the devils we know than to launch an arrow at the sun. This fear is the attitude and policy that I believe must be avoided. Change, openness, and competition has been the driving force of the U.S. economy. Baltia is one attempt to counteract the forces shrinking our ability to compete internationally. There may be others that will try, but they will succeed only if the leadership of our government is willing to accord new entrants the same opportunities in international air commerce that it provides to established carriers.

RECOMMENDATION

To maintain a healthy, competitive international airline industry, in selecting carriers for limited international route authority, new airlines should be allowed to compete with established airlines on the same level playing field. A service proposal should be judged by its merits, not as a protective device for any particular "established" company.

Respectfully,

March 19, 1991

Igor Dmitrowsky, President
Baltia Air Lines, Inc.

BEFORE THE U.S. DEPARTMENT OF TRANSPORTATION

1990 U.S. - U.S.S.R.

North Atlantic Combination Service Case

Docket # 47149



Rebuttal Exhibits of

BALTIA AIR LINES, INC.

BALTIA.

The New Way to Europe

DOT Docket 47149
Exhibit BT-R-105-R
Page 1 of 2
REVISED: 12-3-90

ELAPSED TIMES - MOSCOW/LENINGRAD

BLASPHEM TINES, RICA, MOSCOW, MINSK, KIEV, TBILISI

CARRIER	NY	PHL	SMW	LOW	FRA	OSL	PAR	BIL	NCM	MSQ	BRP	YBS	Elapsed Time- EAST	Elapsed Time- WEST
BALTIMORE	18:00							09:22					08:22 11:51	11:53 9:23
	13:38							11:20	13:51					
	18:00							10:24	09:45					
								11:15						
								09:22						
								11:15						
											13:53		11:51	
											14:40	17:01	15:01	
											09:14	06:45		14:53
	13:38							10:30						
	18:00							11:15						9:23
								09:22						
								11:15						
											13:51		11:51	
											15:45	14:40	13:45	
											08:00	09:03		13:38
											09:50		9:23	
	13:38							10:30						
								11:15						
AMERICAN TRANS AIR	10:45	22:10											11:45*	
		23:40						05:30					12:15*	
								04:30						
		13:50						12:30				07:00		15:10*
												10:00		10:40*
	17:10	14:50						13:30						

*Times do not reconcile with ATA-409

BALTIA

The New Way to Europe

ELAPSED TIMES - WISCON/LCH/HRAD

CARRIER	ATL	ORD	IAD	NY	LAX	DEL	FRA	LED	PRM	Elapsed Time-LAD	Elapsed Time-HOW
TRANS WORLD				18:30			08:20 10:30		15:45 16:30 17:50 06:30 07:50 08:30	13:15 15:20 14:35	13:15 12:35
PAN AMERICAN				17:25 15:00 21:05 15:00 18:00 16:15			10:00 10:45 10:45 12:00 10:15 12:30 09:05 09:40 13:05 14:00	10:35 13:00 17:15 08:45 11:40 13:10	9:40 11:05	9:10 10:00 12:10 14:15	
BALTIA				20:30 18:31			13:04 17:00			8:34 9:31	

BALTIA™*The New Way to Europe*DOT Docket 47149
Exhibit BT-R-111
Page 4 of 4

Interior Comfort Rating

Eight Important Factors That Vary By Market

	Relative Importance by Market		
	U.S. Domestic	Intra-Europe	Long-Range International
Seat Comfort	14%	15%	15%
Cabin Appeal	9	11	7
In-Flight Service	37	39	32
Pre-Flight Service	10	7	7
Flight Smoothness	16	16	16
Spaciousness	14	-	12
Storage	-	12	4
Lavatories	-	-	7
	100%	100%	100%

● Interior Comfort Ratings are Market Sensitive.

BALTIA*The New Way to Europe*

**COMPARISON OF
BALTIA'S 767-200 VS. ATAIR'S 757-200**

FEATURE
(importance factor)

ATA 757-200

BT767-200

SEAT COMFORT
(15%)

32in. Seat Pitch
20in. Shoulder Space

38/34in Seat Pitch
28/21in. Shoulder Space

CABIN APPEAL
(7%)

Narrow Body

Wide Body

IN FLIGHT SERVICE
(32%)

All Tourist
2 Galleys
One Aisle

First/Business/Tourist
6 Galleys
2 Aisles

STORAGE
(7%)

2.0 Cubic Feet

2.7 Cubic
Feet

LAVATORIES
(7%)

4 for 218 Passengers

5 for 205
Passengers

Source: Boeing Commercial Airplane Group, May 1990, D906N226R4, 767 Program Overview, July 1989, Dgt 11260-1144.

BALTIA.

The New Way to Europe

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757/767 CROSS-SECTIONS

757



767



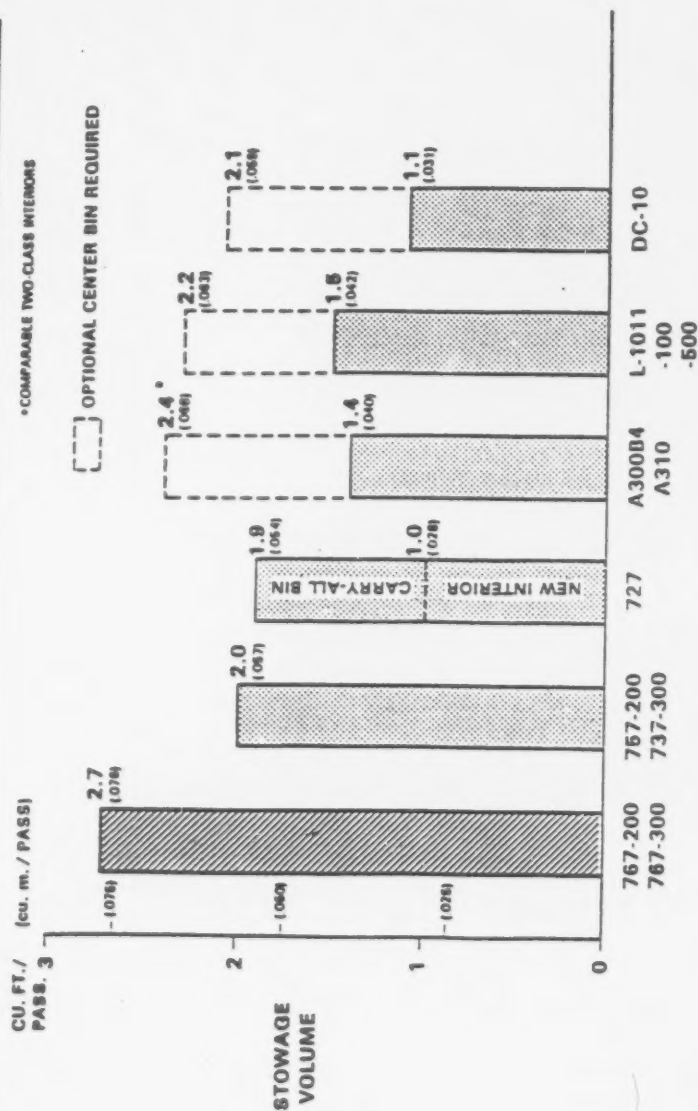
FIRST CLASS

BUSINESS CLASS

ECONOMY AND
INCLUSIVE TOUR

757/767
DOT
DOT

757/767
DOT
DOT

BALTIA.*The New Way to Europe*DOT Docket 4/149
Exhibit BT-R-111
Page 3 of 4**PASSENGER OVERHEAD STOWAGE COMPARISON**

* INSTALLATION OF VIDEO PROJECTIONS REDUCE THIS VALUE

□ 6W88-12
1-17-89

BALTIA.*The New Way to Europe*

DOT Docket 47149
 Exhibit BT-R-323
 Page 1 of 1

**Baltia Air Line's Cargo Service
 to Kiev and Riga
 is Superior to
 American Trans Air and Pan Am**

Characteristic	BT	Riga ATA	PA	BT	Kiev ATA	PA
Number of Weekly Services	5	3	2	5	3	2
Number of Stops (1)	1	0.55	0.4	0.55	0.4	0.4
Widebody Service	1	0	0	0	0	0
No Change of Gauge	1	1	0	0	1	0
Through Container Service	1	0	0	0	0	0
A.M. Arrival Time	1	1	0	0	1	0
P.M. Departure Time from US	1	0	1	1	0	1
Total Ranking	11	5.55	3.4	6.55	5.4	3.4

- Notes:
1. Based on standard QSI values: 1 = 0 stop, 0.55 = 1 stop, .4 = 2 stop.
 2. "1" = Yes, "0" = No.
 3. ATA - American Trans Air, BT - Baltia, PA - Pan Am.

Sources: ATA-T-1, ATA-201
 BT-150, BT-151, BT-153, BT-154
 PA-110

BALTIA™*The New Way to Europe*DOT Docket 47149
Exhibit BT-R-325
Page 1 of 2

**Baltia Air Lines' Aircraft
Choice is Superior to that
of American Trans Air
For Cargo Service
(Pounds)**

	Baltia Air Lines B767-200ER	American Trans Air B757-200ER
Max. Zero Fuel Weight	260,000	186,000
Basic Operating Weight	182,600	125,900
Available Payload	<u>77,400</u>	<u>60,100</u>
Passengers and Baggage	45,510	48,396
Maximum Gross Cargo + Mail	<u>31,890</u>	<u>11,704</u>
Actual Cargo Projections (1)	<u>26,580</u>	<u>2,000</u>
Number of Pallets	3	None
Number of Containers	10	None

Notes: Maximum Number of
Passengers 205 218
Avg. Weight per Passenger + Baggage 222 lb.
Pallet size is: 96 x 125"
Container Type is: LD2

(1) From Direct Exhibits

Sources: BT-001, ATA-T-1, ATA-404, ATA-405
Boeing Commercial Airplane Group

BALTIA*The New Way to Europe*

DOT Docket 47149

Exhibit BT-R-326

Page 1 of 1

**Baltia Air Line's Cargo Service
to Minsk and Tbilisi
is Only U.S. Service**

Characteristic	Minsk			Tbilisi		
	BT	ATA	PA	BT	ATA	PA
Number of Weekly Services	3	0	0	2	0	0
Number of Stops (1)	0.4	0	0	0.4	0	0
Widebody Service	0	0	0	0	0	0
No Change of Gauge	0	0	0	0	0	0
Through Container Service	0	0	0	0	0	0
A.M. Arrival Time	0	0	0	0	0	0
P.M. Departure Time from US	1	0	0	1	0	0
Total Ranking	4.4	0	0	3.4	0	0

Notes: 1. Based on standard OSI values: 1 = 0 stop, 0.55 = 1 stop, .4 = 2 stop.

2. "1" = Yes, "0" = No.

3. ATA - American Trans Air, BT - Baltia, PA - Pan Am.

Sources: ATA-T-1, ATA-201

BT-150, BT-151, BT-153, BT-154

PA-110

BALTIA™*The New Way to Europe*DOT Docket 47149
Exhibit BT-R-605
Page 1 of 3**Baltia's Service
Supplies Most Benefits to Travelers****RIGA**Measuring Quality of Service as a function of the Frequency,
Stops, Aircraft, Seat Capacity and other Comfort Factors
Relevant

<u>Benefit</u>	<u>BT¹</u>	<u>ATA</u>	<u>PA</u>
Number of Weekly Service	5	3	2
Number of Stops ²	1	.55	.4
Widebody Service ³	1	0	0
Seating Pitch & Density ⁴	1	.55	1
Lavatories	1	1	1
Galleys	1	1	1
No Change of Gauge	1	1	0
Network	0	0	1
Gateway ⁵	1	.55	1
P.M. Departure from the US	1	0	1
A.M. Arrival at Kiev	1	1	0
<u>Total Ranking</u>	<u>14</u>	<u>8.65</u>	<u>8.4</u>

¹ BT - Baltia, ATA - American Trans Air, PA - Pan Am² Based on standard QSI values: 1 = 0 stop, 0.55 = 1 stop, 0.4 = 2 stop³ "1" = Yes, "0" = No⁴ "1" = 3 Class Configuration, "0.55" = One Class Economy Configuration, "0.4" = One Class Tour Configuration⁵ New York = 1, Philadelphia = .55
Based on ATA-202, BT-150-155.

BALTIA.*The New Way to Europe*

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 Exhibit BT-R-605-R
 Page 2 of 3
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KIEV

<u>Benefit</u>	<u>BT</u>	<u>ATA</u>	<u>PA</u>
Number of Weekly Service	5	3	2
Number of Stops	.55	.4	.4
Widebody Service	0	0	0
Seating Pitch & Density	1	.55	1
Lavatories	1	1	1
Galleys	1	1	1
No Change of Gauge	0	1	0
Network	0	0	1
Gateway	1	.55	1
P.M. Departure from the US	1	0	1
A.M. Arrival at Kiev	0	1	0
<u>Total Ranking</u>	<u>10.55</u>	<u>8.5</u>	<u>8.4</u>

TBILISI

<u>Benefit</u>	<u>BT</u>	<u>ATA</u>	<u>PA</u>
Number of Weekly Service	2	0	0
Number of Stops	.4	0	0
Widebody Service	0	0	0
Seating Pitch & Density	1	0	0
Lavatories	1	0	0
Galleys	1	0	0
No Change of Gauge	0	0	0
Network	0	0	0
Gateway	1	0	0
P.M. Departure from the US	1	0	0
A.M. Arrival at Kiev	0	0	0
<u>Total Ranking</u>	<u>7.4</u>	<u>0.0</u>	<u>0.0</u>

BALTIA.*The New Way to Europe*

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 Exhibit BT-R-605-R
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MINSK

<u>Benefit</u>	<u>BT</u>	<u>ATA</u>	<u>PA</u>
Number of Weekly Service	3	0	0
Number of Stops	.4	0	0
Widebody Service	0	0	0
Seating Pitch & Density	1	0	0
Lavatories	1	0	0
Galleys	1	0	0
No Change of Gauge	0	0	0
Network	0	0	0
Gateway	1	0	0
P.M. Departure from the US	1	0	0
A.M. Arrival at Kiev	0	0	0
<u>Total Ranking</u>	<u>8.4</u>	<u>0.0</u>	<u>0.0</u>

\\ 605

BALTIA

The New Way to Europe

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Exhibit BT-R-606-R
Page 1 of 1
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SUMMARY OF SERVICE QUALITY FACTORS

TOTAL RANKING

	<u>KIEV</u>	<u>TBILISI</u>	<u>MINSK</u>	<u>RIGA</u>	<u>TOTAL</u>
BALTIA AIR LINES	10.55	7.4	8.4	14	40.35
ATAIR	8.5	0.0	0.0	8.65	17.15
PAN AMERICAN	8.4	0.0	0.0	8.4	16.80

BALTIA PROVIDES MAXIMUM TRAVELER BENEFITS

AVERAGE FREQUENCY USE

CARRIER	TOTAL	FREQ. EQUIV.	BENEFITS PER AVERAGE FREQ. EQUIVALENT
BALTIA	40.35	/ 6.5	= 6.2
ATAIR	17.15	/ 3.9	= 4.4
PAN AMERICAN	16.80	/ 4.0	= 4.2

BALTIA PROVIDES GREATER USE OF AVAILABLE FREQUENCY EQUIVALENTS THAN PAN AM AND ATA COMBINED

BALTIA TOTAL	40.55 / 7 AVAILABLE FREQ. = 5.76
ATA + PAN AM TOTAL	33.95 / 7 AVAILABLE FREQ. = 4.85

BALTIA*The New Way to Europe*

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 Exhibit BT-R-607-R
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TOTAL PASSENGER SERVICE RANKING

**Baltia Provides Greater Benefit to Traveler
 than ATA and Pan Am Overall**

	<u>Riga</u>	<u>Kiev</u>	<u>Minsk</u>	<u>Tbilisi</u>	<u>Totals</u>
Baltia	14	10.55	8.4	7.4	40.35
ATA	8.65	8.5	0.0	0.0	17.15
Pan Am	8.4	8.4	0.0	0.0	16.8

TOTAL CARGO SERVICE RANKING

**Baltia Provides Greater Benefit to Shippers
 than ATA and Pan Am Overall**

	<u>Riga</u>	<u>Kiev</u>	<u>Minsk</u>	<u>Tbilisi</u>	<u>Totals</u>
Baltia	11	6.5	4.4	3.4	25.3
ATA	5.5	5.4	0.0	0.0	10.95
Pan Am	3.4	3.4	0.0	0.0	6.8

Source: (BT-R-605)

BALTIA.*The New Way to Europe*

DOT Docket 47149
 Exhibit BT-R-608-R
 Page 1 of 1
 REVISED: 12-6-90

Baltia Provides Maximum Benefits

Aggregate Shipping & Passenger Benefits

(In rebuttal of ATA-200)

	<u>Passenger</u>		<u>Cargo Service</u>		<u>Total</u>
Baltia	40.35	+	25.3	=	65.65
ATAir	17.15	+	10.95	=	28.1
Pan Am	16.8	+	6.8	=	23.6

Aggregate Frequency Use

	<u>Grand Total</u>		<u>Available Frequency Equivalents</u>		<u>Benefits per Average Freq. Equivalents</u>
Baltia	68.85	/	7	=	9.84
ATAir	17.15	/	7	=	4
Pan Am	16.8	/	7	=	3.4

BALTIA.*The New Way to Europe*

DOT Docket 47149
 Exhibit BT-R-306
 Page 1 of 1

Relative Size Of Top U.S. Gateway Cities To Moscow Kiev and Riga 1/

Year 1989
 Rebus ATA-322 To 333

City	Moscow	Kiev	Riga	Total US O&D Passengers	% Of U.S. Total 2/	% Of New York 3/
	(A)	(B)	(C)	(A + B + C)		
U.S. Total O&D	79,740	490	350	80,580		
New York	27,810	180	140	28,130	35%	
Los Angeles	10,120	20	60	10,200	13%	36%
Washington, D.C.	7,300	60	20	7,380	9%	26%
San Francisco	5,380	40	30	5,450	7%	19%
Chicago	5,230	40	30	5,300	7%	19%
Atlanta	790	0	0	790	1%	3%
Philadelphia	660	0	0	660	1%	2%

1/ From ATA-303, U.S. O&D To Moscow, Kiev and Riga.

2/ City totals divided by Total U.S. O&D Passengers.

3/ City totals divided by New York Passengers.

BALTIA.*The New Way to Europe*
 DOJ Docket 4/149
 Exhibit BT-R-315
 Page 1 of 3

**Baltia Proposes A Reasonable Amount
Of Service Which Matches Projected Demand**

RIGA

Local Market Traffic

	Baltia New York	American Trans Air Philadelphia	Pan Am New York
<i>Revised Exhibit:</i>	BA-107	ATA-322,323,324	PA-331
Base Year 1989	8,000	9,213	12,300
<i>Market Stimulation</i>	20%	200%	13%
Forecast YE Mar 92	13,440	37,852	20,140
Forecast YE Mar 93	18,816	43,531	24,168
Percent Growth			
YE Mar 92 over 89 (Avg Annual)	19%	60%	18%
YE Mar 93 Over YE Mar 92 (Yrly)	40%	15%	20%

Carrier Proposed Weekly Frequencies

	Baltia New York	American Trans Air Philadelphia	Pan Am New York
Forecast YE Mar 92	5 Non Stops	3 One Stops	2 Two Stops
Forecast YE Mar 93	5 Non Stops	4 One Stops	3 Two Stops

BALTIA.*The New Way to Europe*

DOT Docket 47149
 Exhibit BT-R-307
 Page 1 of 2

**American Trans Air
 Projected Traffic Is Much Larger
 From Philadelphia Than Baltia Or Pan Am Projections For New York**

Rebuts ATA-322 To 333

Year Ended March 31, 1992

Riga Traffic Levels

	Originating City	Total Passengers	Times Larger	
American Trans Air	Philadelphia	225,408		
Baltia	New York	13,440 1/	16.8	3/
Pan American	New York	38,820 2/	5.8	3/

1/ Baltia BA-307

2/ PA - 331

3/ Individual carrier traffic divided American Trans Air Total Passenger

BALTIA*The New Way to Europe*

DOT Docket 47149

Exhibit BT-R-315

Page 3 of 3

**Baltia Proposes A Reasonable Amount
Of Service Which Matches Projected Demand**

RJGA

Carrier Share Of Total Traffic

<i>Relevant Exhibits</i>	Baltia New York	American Trans Air Philadelphia
	<i>BA-307</i>	<i>ATA-322 323 324</i>
Forecast YE Mar 92	12,230	30,848
Forecast YE Mar 93	17,123	43,877
Percent Growth YE Mar 92 over 89 (Avg Annual)		
YE Mar 93 Over YE Mar 92 (Yrly)	40%	42%
Percent Share Of Total Market		
Forecast YE Mar 92	91%	14%
Forecast YE Mar 93	91%	17%

Carrier Proposed Weekly Freq

	Baltia New York	American Trans Air Philadelphia	Pan Am New York
Forecast YE Mar 92	3 Non Stops	3 One Stops	2 Two Stops
Forecast YE Mar 93	5 Non Stops	4 One Stops	3 Two Stops

BALTIA.*The New Way to Europe.*DOT Docket 47149
Exhibit BT-R-307
Page 2 of 2

**American Trans Air
Projected Traffic Is Much Larger
From Philadelphia Than Baltia Or Pan Am Projections For New York**

Rebuts ATA-322 To 333

Year Ended March 31, 1992

Kiev Traffic Levels

	Originating City	Total Passengers	Times Larger	
American Trans Air	Philadelphia	95,189		
Baltia	New York	48,687 1/	2.0	3/
Pan American	New York	52,373 2/	1.8	3/

1/ Baltia BA-307

2/ PA - 331

3/ Individual carrier traffic divided American Trans Air Total Passenger

BALTIA.*The New Way to Europe*DOT Docket 47149
Exhibit BT-R-317
Page 3 of 3**Baltia Proposes A Reasonable Amount
Of Service Which Matches Projected Demand****KIEV****Carrier Share Of Total Traffic**

<i>Rebut Exhibit:</i>	Baltia New York	American Trans Air Philadelphia
	BA-307	ATA-322,323,324
Forecast YE Mar 92	39,280	9,119
Forecast YE Mar 93	47,136	13,243
Percent Growth YE Mar 92 over 89 (Avg Annual)		
YE Mar 93 Over YE Mar 92 (Yrly)	20%	45%
Percent Share Of Total Market		
Forecast YE Mar 92	75%	18%
Forecast YE Mar 93	75%	12%

Carriers**requencies**

	Baltia New York	Pan Am New York	American Trans Air Philadelphia
Forecast YE Mar 92	3 One Stops	2 Two Stops	3 One Stops
Forecast YE Mar 93	3 One Stops	3 Two Stops	4 One Stops

BALTIA.*The New Way to Europe*DOT Docket 47149
Exhibit BT-R-408
Page 1 of 2**American Trans Air
Market Share Based On Baltia
And Pan American New York Passenger Forecast***Rebuts AIA 322 To 333***Year Ended March 31, 1992****Riga Traffic Levels**

	Originating City	Total Passengers (A)	American Trans Air Market Share (B)	American Trans Air Traffic (A x B)
American Trans Air	Philadelphia	225,408	14%	31,557
Baltia	New York	13,410	14%	1,882
Pan American	New York	38,820	14%	5,435

*11 Baltia RA 307
21 PA 331*

BALTIA.*The New Way to Europe*DOT Docket 47149
Exhibit BT-K-408
Page 2 of 2

American Trans Air
Market Share Based On Baltia
And Pan American New York Passenger Forecast

Rebuts AIA 322 To 333

Year Ended March 31, 1992

Key Traffic Levels

	Originating City	Total Passengers	American Trans Air Market Share	American Trans Air Traffic
American Trans Air	Philadelphia	95,189	10%	9,519
Baltia	New York	48,687	10%	4,869
Pan American	New York	52,373	10%	5,237

1/ Baltia BA-307
2/ PA - 333

PUBLIC COUNSEL'S TRAFFIC FORECAST FOR BALTIMORE
NEW YORK-RIGA SERVICE
YEARS ENDED MARCH 31, 1992 AND MARCH 31, 1993

Between Riga and	YE	Stimulation 2/ Stimulation	U.S.-Riga Passengers After Stimulation	Baltic Market Share 3/	YE	Stimulation 4/ Passengers
	3/31/92 U.S.-Riga Passengers				3/31/92 Baltic Passengers	
New York	14,070	1254	33,450	804	26,766	32,119
Boston	1,306	10	1,525	50	762	914
Chicago	1,293	10	1,422	50	711	853
Los Angeles	1,721	10	1,893	50	947	1,136
San Francisco	1,141	10	1,255	50	628	754
Washington, D.C.	3,330	10	3,663	50	1,832	2,198
All Others	3,441	10	3,785	50	1,892	2,270
Total	27,182		47,001		33,538	40,244

- 1/ From PC-R-309.
2/ New York stimulation based on the estimate for American at Chicago (PC-R-301) providing daily nonstop service. All other markets are judgment based on first U.S.-flag service, albeit interline connecting.
3/ New York market share based on the estimate for American at Chicago (daily service), Delta at Atlanta (3 days per week), and recognizing that Baltia's service would be the first single-plane service to Riga by any carrier. All other markets are judgment recognizing that (a) this is the first effective U.S.-flag service, and (b) all passengers from behind New York would have to make an interline connection at New York.
4/ Assumes 204 annual growth of Baltia YE 3/31/92 passengers.

PUBLIC COUNSEL'S TRAFFIC FORECAST FOR AMERICAN TRANS AIR'S
PHILADELPHIA-RIGA SERVICE
YEARS ENDED MARCH 31, 1992 AND MARCH 31, 1993

Between Riga and	YE 3/31/92	U.S.-Riga Passengers 1/	Stimulation 4/	U.S.-Riga Passengers After Stimulation	ATA Market Share 5/	YE 3/31/92 ATA Passengers	YE 3/31/93 ATA Passengers 6/
	83 2/		100%				
Philadelphia	14,870		0	166	75%	125	150
New York	1,346		0	14,870	25	3,718	4,462
Boston	1,293		0	1,366	10	139	167
Chicago	1,721		0	1,293	25	323	388
Los Angeles	1,141		0	1,721	25	430	516
San Francisco	3,330		0	1,141	25	285	342
Washington, D.C.			0	3,330	25	832	998
All Others	3,358 3/		0	3,358	25	840	1,008
Total	27,182			27,265		6,692	8,091

1/ From PC-R-309 unless noted.

2/ 1-108 Philadelphia-Moscow passengers at YE 3/31/92 (PC-R-307). Riga at 7.5% of Moscow figure.

3/ All others in PC-R-309 for Riga, less the 83 shown for Philadelphia.

4/ Philadelphia stimulation based on the estimate for American at Chicago (PC-R-301) providing daily nonstop service. While ATA's Riga service would be one-stop via Shannon, it represents a significant improvement over existing service. Since behind Philadelphia service would be interline connecting involving a change of planes/carriers at Philadelphia plus a stop at Shannon, such service would not appear to be of a stimulative nature for behind Philadelphia passengers.

5/ See note 3, PC-R-303. Estimates for ATA are reduced to reflect the added stop at Shannon and Boston share further reduced to reflect that Boston-Riga via Philadelphia is more of a backhaul than Boston-Riga via New York.

6/ Assumes 20% annual growth of ATA YE 3/31/92 passengers.

BALTIA.

The New Way to Europe

DOT Docket 47149
Exhibit 9T-R-410
Page 1 of 1

American Trans Air
System Financial Results
Using ATA % Share Of Baltia Market Forecast 1/
(Including Shannon Passengers)
Rebuts ATA-401

Year Ended March 31, 1992

	PHL-SNN	PHL-RIX	PHL-IEV	SNN-RIX	SNN-IEV	Total Passengers
ATA Forecast Passengers	11,273	1,882	4,869	617	182	18,822
Operating Revenues	Revised System Results					
Passenger Revenues	8,752,534					
Transport Revenues	437,627					
Cargo Rev.	90,000					
Other Pass. Service	35,010					
Total Revenues	9,315,173					
OPERATING EXPENSES	TOTAL					
Direct Expenses	11,701,000					
Pass. Food (PHL-SNN)	249,875					
Flight Attendants	1,283,831					
Other Pass. Service	100,928					
Total Passenger Service	1,634,634					
Total Aircraft & Traffic Service	4,719,000					
Commissions	437,627					
Advertising And Promotions	262,576					
CRS Fees	27,669					
Resv. And Sales Personnel	128,492					
Total Promo And Sales	856,363					
General And Administrative	1,021,194					
Amortization	15,351					
Transported Related Expenses	115,096					
Total Indirect Expenses	8,261,838					
Total Operating Expenses	20,062,838					
Operating Profit	-11,310,362					
Profit Margin	-121%					

1/ ATA Share of passengers multiplied by Baltia total market forecast for Rix and Kae revenue and passengers related expenses.

BALTIA.*The New Way to Europe*DOT Docket 47149
Exhibit BT-R-409
Page 1 of 1

American Trans Air
System Financial Results
Using ATA % Share Of Pan American Market Forecast 1/
(Including Shannon Passengers)
Rebuss ATA-401

Year Ended March 31, 1992

	PHL-SNN	PHL-RIX	PHL-IEV	SNN-RIX	SNN-IEV	Total Passengers
ATA Forecast Passengers	11,273	5,435	5,237	617	182	22,744
Operating Revenues	Revised System Results					
Passenger Revenue	10,742,544					
Transport Revenue	537,127					
Cargo Rev	90,000					
Other Pass. Service	42,970					
Total Revenue	11,412,641					
OPERATING EXPENSES	TOTAL					
Direct Expenses	1,800					
Pass. Fund (PHL-SNN)	314,059					
Flight Attendants	1,283,831					
Other Pass. Service	126,667					
Total Passenger Service	1,724,557					
Total Aircraft & Traffic Service	4,719,000					
Commissions	537,127					
Advertising And Promotions	322,276					
CRS Fees	33,434					
Rev. And Sales Personel.	161,260					
Total Promo And Sales	1,834,097					
General And Administrative	1,206,727					
Amortization	15,551					
Transported Related Expenses	141,264					
Total Indirect Expenses	8,691,198					
Total Operating Expenses	20,392,196					
Operating Profit	-9,649,654					
<i>Profit Margin</i>	-85%					

1/ ATA Share of passengers multiplied by Pan American total market forecast for Rign and
Karr revenue and passengers related expenses.

BALTIA*The New Way to Europe*DOT Docket 47149
Exhibit BT-R-411
Page 1 of 1Trans World
Attributes 100% of Passenger Revenues To The
Frankfurt - Moscow - Leningrad Operation 1/

Rebut TW-400

Year Ended March 31, 1992

Market	Total Passenger (A)	Average Fare (B)	Total Passenger Revenues (C) = (A x B)	
New York To Moscow	29,381	\$572	16,805,932	
Moscow To New York	9,794	\$745	7,296,530	
All Other Markets			11,637,236	
Total New York - Moscow			\$35,739,698	(D)
New York To Leningrad	5,185	\$572	2,965,820	
Leningrad To New York	1,728	\$745	1,287,360	
All Other Markets			2,054,242	
Total New York - Leningrad			\$6,307,422	(E)
System Total Passenger Revenues			\$42,047,120	(F = (D + E))
Passenger Revenues (TW-400)			\$42,047,119	(G)
Difference			\$1	(H = (F - G))

1/ From TW-401 and TW-201

BALTIA.*The New Way to Europe*DOT Docket 47149
Exhibit BT-R-316
Page 2 of 3**Baltia Proposes A Reasonable Amount
Of Service Which Matches Projected Demand****LENINGRAD****Total Market Traffic**

	Baltia New York	Pan Am New York	TWA New York	Delta Atlanta	Continental Newark
<i>Robins Exhibit:</i>	BA-107	PA-231	TW-100	DL-103	CO-102
Base Year 1989	28,732	95,585	47,067		
Forecast YE Mar 92	77,232	121,717	52,671		
Forecast YE Mar 93	100,482	141,451	55,305		
Percent Growth					
YE Mar 92 over 89 (Avg Annual)	39%	26%	4%		
YE Mar 93 Over YE Mar 92 (Yrly)	38%	16%	5%		

Carrier Proposed Weekly Frequencies

	Baltia New York	Pan Am New York	TWA New York	Delta Atlanta	Continental Newark
Forecast YE Mar 92	5 Non Stops	3 One Stops	7 Two Stops		
Forecast YE Mar 93	5 Non Stops	4 One Stops	7 Two Stops	2 One Stops	2 One Stops

BALTIA*The New Way to Europe*

DOT Docket 47149

Exhibit BT-R-316

Page 3 of 3

**Baltia Proposes A Reasonable Amount
Of Service Which Matches Projected Demand**

LENINGRAD

Carrier Share Of Total Traffic

	Baltia New York	Pan Am New York	TWA New York	Delta Atlanta	Continental Newark
<i>Relevant Exhibits:</i>	BA-107	PA-131	TW-100	DL-103	CO-302
Forecast YE Mar 92	59,973	17,240	9,480		
Forecast YE Mar 93	66,265	22,681	9,954		
Percent Growth YE Mar 92 over 89 (Avg Annual)					
YE Mar 93 Over YE Mar 92 (Yrly)	30%	32%	5%		
Percent Share Of Total Market					
Forecast YE Mar 92	66%	14%	18%		
Forecast YE Mar 93	66%	16%	18%		

Carrier Proposed Weekly Frequencies

	Baltia New York	Pan Am New York	TWA New York	Delta Atlanta	Continental Newark
Forecast YE Mar 92	5 Non Stops	3 One Stops	7 Two Stops		
Forecast YE Mar 93	5 Non Stops	4 One Stops	7 Two Stops	2 One Stops	2 One Stops

PUBLIC COUNSEL'S TRAFFIC FORECAST FOR BALTIA'S
NEW YORK-LENINGRAD SERVICE
YEARS ENDED MARCH 31, 1992 AND MARCH 31, 1993

Between Leningrad and	YE 3/31/92 U.S.-Leningrad Passengers 1/	U.S.- Leningrad Passengers		Baltia Market Share 3/	YE		YE 3/31/93 Baltia Passengers 4/
		Stimulation 2/	After Stimulation		3/31/92 Baltia Passengers	3/31/92 Baltia Passengers	
New York	49,569	50%	74,354	70%	52,047	52,047	62,456
Boston	4,619	0	4,619	25	1,155	1,155	1,386
Chicago	4,310	0	4,310	25	1,078	1,078	1,294
Los Angeles	5,738	0	5,738	25	1,434	1,434	1,721
San Francisco	3,803	0	3,803	25	951	951	1,141
Washington, D.C.	11,100	0	11,100	25	2,775	2,775	3,330
All Others	11,470	0	11,470	25	2,868	2,868	3,442
Total	90,609		115,394		62,308	62,308	74,770

1/ From PC-R-109.

2/ Stimulation at New York reduced from estimate for Riga due to availability of some Pan Am change of gauge service and foreign-flag on-line connections. (OMG, July 1989). No stimulation assumed at other U.S. cities due to the availability of on-line and interline connecting service.

3/ Market share reduced from Riga share based on Pan Am and other carriers providing on-line service in the market (OMG, July 1989).

4/ Assumes 20% annual growth of Baltia YE 3/31/92 passengers.

BALTIA*The New Way to Europe*DOT Docket 47149
Exhibit BT-R-311
Page 1 of 2**TWA PROJECTED AVERAGE ANNUAL PASSENGERS****FRANKFURT - MOSCOW (1)**

YEAR	TOTAL	AVERAGE PASSENGERS PER DAY
1991	53,717	147
1992	56,403	154

**TWA AVERAGE ANNUAL LOAD FACTOR
TRANS ATLANTIC (2)**

1987	64.0 %
1988	63.7 %
1989	63.1 %

**TWA 747 PASSENGER CAPACITY
NEW YORK TO FRANKFURT TO MOSCOW (3)****1989**

271	(63.1% of 431 seats)
<u>+147</u>	(Avg. Passengers per Day To Moscow)
418	(97% of Load Factor)

Source: (1) Direct Exhibits: TWA-300.

(2) Airline Economics, *Airline Quarterly*, Summer 1990.

(3) Airline Seating Guides, Spring 1990, Carlson Publishing Co.

BALTIA.*The New Way to Europe*DOT Docket 47149
Exhibit BT-R-403
Page 1 of 1Trans World
B727 Operation Revenue and Expenses
Based on Segment Results

Rebuts TW-400

Year Ended March 31, 1992

Allocated Passenger Revenues

New York-Frankfurt - Moscow	\$8,817,969
New York - Frankfurt - Leningrad	1,882,140

Cargo Revenues TW-404

New York-Frankfurt - Moscow	377,740
New York - Frankfurt - Leningrad	29,541
Frankfurt-Moscow	427,000
Frankfurt - Leningrad	77,000
Moscow - Leningrad	10,000

Total Allocated Revenues - B727 Operations	\$11,621,391
--	--------------

Total Operating Expenses - B727 Operations (TW-400)	\$37,268,940
---	--------------

Profit (Loss) From B727 Operations	(\$25,647,549)
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BALTIA.*The New Way to Europe*

DOT Docket 47149

Exhibit BT-R-404

Page 1 of 1

**Allocation Of Trans World
New York - Moscow Passenger Revenues
Based on Segment Miles**

Rebuts TW-400

Year Ended March 31, 1992

Segment	Segment Mileage	% Of Total Miles
New York - Frankfurt	3,856	75%
Frankfurt-Moscow	1,263	25%
Total New York - Moscow	5,119	

Distribution Of Passenger Revenues Based Miles

Passenger Revenues (TW-401)	\$35,739,654	
New York - Frankfurt Allocated Revenue	75%	\$26,921,685
Frankfurt-Moscow Allocated Revenue	25%	\$8,817,969

BALTIA.*The New Way to Europe*DOT Docket 47149
Exhibit BT-R-405
Page 1 of 1Allocation Of Trans World
New York - Leningrad Passenger Revenues
Based on Segment Miles

Rebus 7W-400

Year Ended March 31, 1992

Segment	Segment Mileage	% Of Total Miles
New York - Frankfurt	3,856	70%
Frankfurt-Moscow-Leningrad	1,640	30%
Total New York - Leningrad	5,496	

Distribution Of Passenger Revenues Based On Miles

Passenger Revenues (W-400)	\$6,307,465	
New York - Frankfurt Allocated Revenue	70%	\$4,425,325
Frankfurt-Leningrad Allocated Revenue	30%	\$1,882,140

PC-ADJUSTED
BALTIMORE AIR OPERATIONS MEMORANDUM
12 Months Ended March 31, 1952

Operating Income Statement

	System Landing & Rigo	New York- Long Island	Operation System	Rigo New York- Baltim
INCOME STATEMENT				
Scheduled Passenger Revenue	79,015,550	36,879,062	112,256,507	
Scheduled Freight Revenue	876,489,848	839,646,108	841,846,122	82,835,393
Charter Revenue	607,937	309,900	938,937	857,074
Other Revenue	88	88	88	88
Total Revenue	879,654,000	836,835,070	843,440,432	83,687,062
Flying Ops Fuel Pool Maint Dept	66,899,129	82,771,239	93,877,690	81,000,443
Pool	89,617,260	86,815,639	95,491,829	84,009,945
A/C Rentals	817,269,200	88,015,074	99,284,126	87,304,926
Maintenance	86,774,000	82,840,236	93,325,254	87,344,001
Passenger Service Labor	81,646,987	81,482,763	82,357,324	81,080,733
Passenger Service All Other	81,636,982	8556,802	8076,079	8554,345
A/C and Traf Serv & Land Fees	814,491,618	89,486,650	99,802,978	85,493,306
Passenger Commissions	88,163,912	82,610,076	86,893,236	84,248,285
Fuel & Sales Fuel Commissions	83,641,689	81,474,207	82,307,402	8090,439
General & Administrative Exp	84,287,278	81,811,265	82,479,687	81,824,066
Depreciation and Amortization	83,935,914	81,819,679	82,415,836	81,317,487
Other Expenses	82,634,204	81,300,369	81,535,837	81,115,509
Total Operating Expenses	882,791,246	834,797,469	847,993,857	835,826,061
Operating Profit/Loss	(-89,137,246)	(-97,962,399)	(84,630,424)	(82,374,310)
Secret See Page 2	(55,071)	3,170,959	(3,111,075)	

Subd. Rev.
Difference:

3,874,915 711,586

772.00 TBS
760.87 MSQ
759.75 HAV
759.75 MOW
598.92 RIF590.92 LEO
844.400.745Av. Weighted Diluted
Correct Fare:

PC-405-1950
 MAINTENANCE AND OPERATIONS REPORT
 12 Months Ended March 31, 1953

Operating Income Statement

	System	New York- Long Island	Operation System	Rigo	New York- Rigo	Rigo
INCOME STATEMENT						
Scheduled Passenger Revenue	\$1,000,000	44, 123, 073	54, 111, 077			
Scheduled Freight Revenue	990, 332, 016	890, 997, 909	890, 376, 419			
Charter Revenue	81, 016, 759	837, 971	846, 880		846, 946, 582	83, 407, 836
Other Revenue	82, 759, 864	81, 018, 110	81, 741, 786		80	80
Total Revenue	994, 119, 279	942, 981, 904	922, 796, 493		849, 092, 317	83, 465, 378
	72, 577, 051	75, 577, 051	75, 577, 051			
Flying Ops Fuel Pool	16, 899, 120	12, 771, 239	12, 771, 239		82, 787, 446	81, 040, 443
Pool	89, 417, 260	84, 015, 430	89, 401, 829		84, 009, 843	81, 331, 004
A/C Maintenance	81, 739, 200	80, 013, 076	80, 254, 136		81, 304, 936	81, 059, 200
Passenger Service Labor	96, 776, 480	82, 940, 916	83, 825, 354		82, 944, 891	80, 000, 663
Passenger Service All Other	83, 040, 007	81, 082, 763	82, 357, 234		81, 480, 733	80, 76, 591
A/C and Tref Serv + Land Pools	81, 712, 233	80, 000, 971	81, 091, 282		84, 737, 507	80, 33, 663
Passenger Commissions	81, 677, 602	85, 581, 100	89, 096, 421		85, 586, 749	82, 509, 672
From 9 Sales Rail Commissions	89, 890, 309	84, 379, 353	85, 321, 036		85, 347, 537	83, 75, 459
General & Administrative Exp	84, 033, 936	81, 749, 040	82, 044, 077		81, 786, 003	81, 070, 074
Depreciation and Amortization	84, 465, 100	81, 087, 147	82, 377, 950		81, 500, 190	80, 00, 769
Other Expenses	83, 939, 314	81, 319, 070	82, 419, 036		81, 517, 487	80, 00, 349
Total Operating Expenses	82, 780, 100	81, 152, 914	81, 505, 346		81, 154, 735	80, 00, 851
Operating Profit/Loss	809, 903, 041	836, 103, 342	849, 779, 639		836, 507, 039	813, 232, 659
	80, 147, 237	88, 260, 343	82, 070, 994		812, 336, 270	80, 347, 204
	17, 624, 366	3, 593, 734	5, 330, 452			

Source: See Page 2

 Sub-Post Rev.
 Difference:

 As Weighted Diluted
 Correct Fare:

4, 225, 991

570.42 LEO

 778.00 TBS
 744.00 MSA
 759.35 LEW
 753.35 MSA
 598.92 RIF

PC-ADVISED
AMERICAN TRAM AIR
SUMMARY OF OPERATING FORECAST RESULTS
(in \$000)

	YE 3/31/72
OPERATING REVENUES	
Passenger Revenue	\$13,254,267
Transport Mail Revenue	\$457,710
Cargo Revenue (Net)	\$79,000
Other Revenue	\$54,723
TOTAL OPERATING REVENUES	\$14,145,670
OPERATING EXPENSES	
Direct Expense - FAL-AM	\$0,037,000
Direct Expense - AM-BII	\$3,340,000
Direct Expense - EIS-IV	\$1,704,000
Indirect Expense - FAL-AM	\$4,031,970
Indirect Expense - AM-BII	\$2,364,000
Indirect Expense - EIS-IV	\$2,109,260
TOTAL OPERATING EXPENSES	\$20,966,940
TOTAL OPERATING PROFIT	(\$6,790,172)

Source: AEA-401, Pages 3-7 of this exhibit.

PC-ADJUSTED
AMERICAN TRANS AIR
SUMMARY OF OPERATING FORECAST RESULTS
(in 000s)

	YE 3/31/93
OPERATING REVENUES	
Passenger Revenue	\$16,789,639
Transport Mail Revenue	835,282
Cargo Revenue (Net)	817,000
Other Revenue	849,493
TOTAL OPERATING REVENUES	\$17,796,414
OPERATING EXPENSES	
Direct Expenses - FTL-AM	\$6,637,000
Direct Expenses - AM-ALX	\$2,240,000
Direct Expenses - EIL-IVY	\$1,784,000
Indirect Expenses - FTL-AM	\$9,578,828
Indirect Expenses - AM-ALX	\$4,881,983
Indirect Expenses - EIL-IVY	\$2,182,240
TOTAL OPERATING EXPENSE	\$24,445,133
TOTAL OPERATING PROFIT	(\$6,760,729)

Sources: EIS-401; Pages 2-7 of this exhibit

THE INTERNATIONAL BUSINESS LAW FIRM P.C.

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ABAnet: IBLF.ARL

May 1, 1991

Mr. David Traynham
Professional Staff Member
House Aviation Subcommittee
2165 Rayburn HOB
Washington, DC 20515

Dear Mr. Traynham:

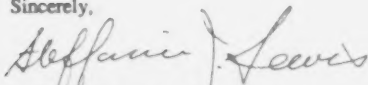
Re: Pursuant Your Phone Call Requesting
Letter to Accompany Documents for the Record

Please include DOT Order 91-3-53 and selected Exhibits from DOT docket 47149 in the record of the Aviation Subcommittee hearing, March 21, 1991, *A Review of International Aviation Policy and Bilateral Agreements*. The selected exhibits do not represent any sizeable fraction of the full record, and the selection is intended to show certain relative attributes of Baltia's proposal that were outweighed, at least in the ALJ's Recommended Decision, by the competitors' condition of operating experience. The Exhibits are submitted to raise the question: Does a policy favoring large carriers exist as a barrier to entry.

I apologize for the delay in responding to your telephone request for this letter. Shortly after referenced phone call, my former husband of 21 years, father of my daughter and air service/airline partner died in a mid-air collision in Alaska. I have been out of town handling the matter.

Please phone me if you have any further request in this matter.

Sincerely,



Steffanie J. Lewis
Counsel for Baltia Air Lines, Inc.

Enclosure: List of Selected Exhibit

cc: All parties on the Seventh Revised Service List-Docket 47149

Selected Exhibits from Docket 47149
Filed in the Record of House Aviation Subcommittee Hearing
March 21, 1991
Aviation Policy & Bilateral Agreements

1. Relevant to show proposed services.
BT-R-105-R p. 1
BT-R-105/R2 p. 2
2. Relevant to question whether a colorable basis exists for suggesting that a potential disposition toward large carriers could have influenced the ALJ's finding that the proposed B757 service is superior to the proposed B767 service.
BT-R-111 pp. 1-4
BT-R-323 p. 1
BT-R-325,326 pp. 1
BT-R-605 p. 1
BT-R-605-R pp. 2-3
BT-R-606-R thru 608-R pp. 1
3. Relevant to question whether a colorable basis exists for suggesting that a potential disposition toward large carriers could have influenced the finding that Baltia's proposal was less appropriate to market conditions, *i.e.* represented greater risk, than competing proposals in the Leningrad and non-Moscow markets.
BT-R-306 p.1
BT-R-315 pp.1,3
BT-R-307 pp.1,2
BT-R-317 p.3
BT-R-408 pp.1,2
PC-R-302 p.1
PC-R-303 p.1
BT-R-409 p.1
BT-R-410 p.1
BT-R-411 p.1
BT-R-316 pp.2,3
PC-R-307A p.1
PC-R-303A p.1
BT-R-311 p.1
BT-R-403 thru 405 pp.1
PC-R-402-405 pp.1 (with corrected fares)

Order 91-1-65

UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C.

SERVED JAN 30 1991

Issued by the Department of Transportation
on the 30th day of January, 1991

Application of ----- :
 :
 BALTIA AIR LINES, INC. : Docket 47037
 :
 for a certificate of public convenience :
 and necessity under section 401(d)(1) :
 of the Federal Aviation Act to engage :
 in foreign scheduled air transportation :
 ----- :

ORDER TO SHOW CAUSE

On July 5, 1990, Baltia Air Lines, Inc. (Baltia) a newly formed, non-operating company, filed an application in Docket 47037 for a certificate of public convenience and necessity to provide scheduled foreign air transportation of persons, property, and mail pursuant to section 401(d)(1) of the Federal Aviation Act. Baltia proposes to operate five non-stop round-trip flights per week between JFK International Airport in New York and Leningrad, Soviet Russia, and between JFK and Riga, Soviet Latvia, with Boeing 767-200ER aircraft. Baltia also proposes to provide service beyond Riga to Minsk, Soviet Byelorussia; Kiev, Soviet Ukraine; Tbilisi, Soviet Georgia; and Moscow, Soviet Russia, with Boeing 737-200 aircraft. ^{1/}

The applicant has filed the information required by section 204.5 of our regulations for an examination of its fitness. We have received no answers to the application and no special issues regarding the applicant have come to our attention requiring an oral hearing or further procedures for their resolution. Under these circumstances, we propose to decide the issue of Baltia's fitness to engage in its proposed air transportation operations on the basis of the written record.

We tentatively conclude, on the basis of the tentative findings below, that Baltia is a citizen of the United States and is fit, willing, and able to provide the services proposed and to comply with the Act and our orders and regulations. We will give interested persons an opportunity to show cause why we should not adopt as final these tentative findings and conclusions.

^{1/} Baltia also filed an application in Docket 47149, the 1990 US-USSR North Atlantic Combination Service Case, seeking to be selected to provide the US-USSR air service.

FITNESS

The Department uses a three-part fitness test that reconciles the Airline Deregulation Act's liberal entry policy with Congress' concern for operational safety and consumer protection. The three areas of inquiry that must be addressed in order to determine a carrier's fitness are whether the applicant (1) will have the managerial skills and technical ability to conduct the proposed operations; (2) has access to financial resources which are sufficient to commence operations without posing an undue risk to consumers; and (3) will comply with the Act and regulations imposed by Federal and State agencies.

The Company

Baltia, located in Rego Park, New York, was formed under the laws of New York in August 1989. The company's stock is distributed as follows: Mr. Igor Dmitrowsky, Chairman and President, 64.2 percent; other members of management team, 16.2 percent; Ms. Steffanie J. Lewis, The International Business Law Firm, P.C., Counsel, 6.4 percent; Airline Economics, Inc., Financial Consultant, 4.8 percent; and other individuals, 8.4 percent. If it is found fit and is designated to provide the US-USSR air service, Baltia expects to acquire start-up capital of approximately \$50 million from the subscribing insurers of the Delaware Insurance Commissioner's Economic Development Fund. The applicant proposes to lease two 205-seat B-767-200ER aircraft for the New York-Leningrad and New York-Riga segments and two B-737-200 aircraft for the connecting service from Riga to Minsk, Kiev, Tbilisi, and Moscow.

Managerial Competence

Mr. Igor Dmitrowsky is Baltia's founder and owns 64 percent of its stock. He serves as Chairman of the Board of Directors, President and Chief Executive Officer, with responsibility for all of the company's day-to-day policy and procedure. Mr. Dmitrowsky was born in Latvia and is now a U.S. citizen. His background has been in engineering and marketing. He was employed as a designer-engineer of industrial mechanical and structural projects by Atlantic Design Company of Newark, New Jersey (1976-77), and as chief engineer in charge of new product development and plant operations by Durst Industries of New York (1977-79). In 1979, he founded American Kefir Corporation in Fairlawn, New Jersey, a producer and marketer of a yogurt-type product. He served as President of American Kefir until 1981 and as Director and Management Consultant until 1986. During 1987 and 1988, Mr. Dmitrowsky was self-employed in financing and developing a new design for a single-pilot aircraft before he undertook the development of Baltia in 1989. He is a licensed private pilot.

Mr. Anthony J. Hanson is Executive Vice President of Baltia. As such, he is responsible to the President for the implementation of policy and procedure. From 1981 until joining the applicant, Mr. Hanson worked for Orion Air as Chief Pilot and Vice President

of Flight Operations. His responsibilities included budget development and management of financial resources for all flight operations. He also developed technical policies and procedures for the company's flight operations and was responsible for the day-to-day operation of 24 aircraft plus operations personnel performing contracted service for United Parcel Service. Prior to becoming affiliated with Orion, Mr. Hanson served for two years as an officer in the U.S. Air Force where he was responsible for a \$22 million fuel inventory. He holds 1.2 percent of Baltia's stock.

Mr. Harold J. Pareti has been named Vice Chairman of the Board of Directors and Acting Vice President of Finance, a position which reports to the President. He is a principal in Airline Economics, Inc., which firm has been engaged in a consultant capacity to assist Baltia with the government certification process and capitalization. Mr. Pareti's achievements include having successfully financed the start-up of two air carriers, People Express and Presidential Airlines. Baltia states that it will consider the suggestions to be made by the major investors from the Delaware Insurance Commissioner's Economic Development Fund before deciding on an individual to hold the position of Chief Financial Officer.

Mr. Indulis Ozols is Baltia's Vice President-Flight Operations. He reports to the Executive Vice President and is responsible for overall planning, direction, and day-to-day management of flight operations. A native of Latvia, Mr. Ozols received a B.S. degree in Aeronautical Studies and Flight Technology from Embry-Riddle Aeronautical University in Florida. He holds an Airline Transport Pilot certificate from the FAA and has logged over 17,000 hours of flight time. Following U.S. Army Flight School, Mr. Ozols was employed as a flight instructor with Ross Aviation Flight Training in Fort Rucker, Alabama (1960-64). From 1965 to 1989, he was a captain with Eastern Air Lines. From 1989 until he joined Baltia, he was employed by Metropolitan Helicopters of Manassas, Virginia, as Chief Pilot and Chief Flight Instructor. Mr. Ozols, who is a citizen of the United States, owns 3.3 percent of the applicant's stock.

Mr. Reginald Ilgvars Norbergs is the applicant's Vice President-Technical Services. He reports to the Executive Vice President and is responsible for overall planning, direction, and coordination of Baltia's maintenance activity. Mr. Norbergs was born in Riga and became a citizen of the United States. He completed maintenance training on and has maintained and inspected a variety of aircraft types, including those proposed to be operated by Baltia, and is licensed by the FAA as an Airframe and Powerplant Mechanic. Mr. Norbergs retired in 1989 after spending 26 years with Trans World Airlines in various maintenance positions, including Quality Assurance Airworthiness Inspector and, for the past 17 years, Inspector for Power Plant Overhaul and Repair in Kansas City. From 1976 to 1986, he was assigned by TWA to serve as Supervisor of Inspection for the Saudia fleet in Jeddah, Saudi Arabia; Hamburg, Germany; and Hong Kong. He owns 3.2 percent of Baltia's stock.

Mr. Brian P. Glynn is the applicant's Vice President-Customer Service and Marketing with responsibility for the overall planning, direction, and coordination of customer service and marketing activities. He reports to the Executive Vice President. Mr. Glynn served from 1982 to 1989 as Vice President of Operations for American Kefir Corporation. With Mr. Dmitrowsky, he developed and marketed the company's yogurt product, attracted the necessary start-up and operating capital, and designed marketing programs which facilitated effective regional product distribution. Mr. Glynn was responsible for manufacturing and quality control, customer relations, and negotiation of the company's initial public offering. He owns 1.9 percent of the company's stock.

Mr. Stanley Midnight has joined Baltia as Director of Flight Standards and Chief Pilot. He is responsible to the Vice President of Flight Operations for the execution of standard operating procedures for all aircraft and pilots. Mr. Midnight spent 22 years as an airline captain with Braniff International Airways (1965-82) and Northeastern International Airways and United Air Lines (1982-87). In 1987, he was hired by Pan American World Airways to assist in obtaining the FAA certificate authority for its new Shuttle operation. He shared responsibility for developing the company's manuals for flight operations, aircraft operations and training, and was promoted to Chief Pilot for the Pan Am Shuttle. In June 1989, Mr. Midnight joined North American Airlines as Vice President-Operations and B-757 captain. While there, until June 1990, he was responsible for development of all operational aspects of the airline during the certification phase. Mr. Midnight, who has an FAA-issued Airline Transport Pilot certificate and nearly 16,000 hours as an airline officer and captain, also has served as Chairman of the Air Safety Committee of the Air Line Pilots Association and was twice elected that organization's Local Executive Council Chairman for New York. He holds 1.3 percent of Baltia's stock.

Baltia has named Mr. Robert L. Hughes as Director of Maintenance and Training. He supervises the activities of the maintenance department and is responsible to the Vice President-Technical Services. He was Senior Vice President of Operations and Maintenance for Arrow Air in Miami from April 1989 to August 1990 where he was responsible for all operations and maintenance areas. From 1983 to 1989, Mr. Hughes owned and operated Arel Aviation Service, Inc., an FAA-approved repair station located at Lynbrook, New York. He was one of the original founders of New York Air and served that carrier from 1980 to 1983 as Staff Vice President-Technical Services, Purchasing and Supply. He was responsible for preparation of the technical manuals required for FAA certification as well as for the maintenance of the carrier's fleet. He developed the carrier's maintenance organization and administered the contracts for technical services and outside vendors employed by New York Air. Mr. Hughes has also been employed by Seaboard World Airlines as Director of Product Support and Purchasing (1978-80), Overseas National Airways as Assistant Vice President-Maintenance and Engineering and Director of Maintenance (1967-79), and Saturn Airways as Chief Flight Engineer, Director of Maintenance, and Assistant Vice President-Maintenance and Operations.

(1951-67). He holds an FAA Airframe and Powerplant Mechanic certificate.

Baltia's Board of Directors is composed of five individuals: Mr. Igor Dmitrowsky, Chairman; Mr. Harold J. Pareti of Airline Economics, Inc., Vice-Chairman; Mr. Russell Thayer, an aviation consultant; Ms. Shirley Ybarra, an aviation consultant and formerly Special Assistant to a U.S. Secretary of Transportation; and Mr. Ojars Blumbergs, a citizen of Latvia and an elected representative of the Parliament of Latvia. Mr. Ozols has been named special advisor to the Board concerning operations. Except for Mr. Blumbergs (who owns no stock in the company), all of these individuals are U.S. citizens.

Considering the experience and background of the applicant's key personnel and the fact that the FAA must also review the qualifications of certain of these individuals to determine if they meet the requirements for their positions, we tentatively conclude that Baltia has demonstrated that it has the management skills and technical ability to conduct its proposed service. 2/

Financial Plan and Operating Proposal

In support of its plan of operations and proposed financing, the applicant submitted detailed analyses of market, traffic, operating cost, and financing considerations related to its proposed operations. Documents submitted include a schedule of anticipated pre-operating expenses, a pre-operating balance sheet as of December 20, 1990, and pro forma profit and loss statements for its first five years of normal operations, showing operating assumptions, derivations of unit costs, and revenue and yield projections.

Baltia's forecasts are based on initiating certificated scheduled passenger service in April 1991 with one round-trip flight each weekday between JFK International Airport in New York and Leningrad and between JFK and Riga with two leased 205-seat B-767-200ER aircraft configured with a 25-seat first-class section, a 30-seat business-class section, and a 150-seat coach-class section. The company also proposes to offer connecting service, with a change of gauge to 115-seat B-737-200 aircraft, to Moscow five days per week, to Minsk and Kiev three days per week, and to Tbilisi two days per week.

The applicant states that it derived its operating cost estimates from adjusted costs experienced by People Express's transatlantic service, from unit costs reported by carriers on their Form 41 reports to the Department, and from estimates furnished by prospective suppliers. Baltia states that it computed its projected

2/ Before authorizing a carrier to conduct air transportation operations, the FAA evaluates certain of the carrier's key personnel with respect to the minimum qualifications for those positions as prescribed in Part 121 of the Federal Aviation Regulations.

aircraft lease expense based on the ratio of the industry average monthly lease expense to aircraft fair market value. Baltia has provided letters from three aircraft leasing concerns which have committed to lease two B-767 and B-737 aircraft on condition that Baltia is designated to provide the USSR service.

Estimated fuel costs are based on those experienced by carriers in Atlantic service during the last two quarters of 1989 and the first two quarters of 1990. Baltia has provided a letter from a major jet aviation fuel supplier stating that its fuel needs can be met at JFK Airport at prices paid by comparable air carriers. The applicant also states that it has received assurances of adequate fuel supplies at nearly all of the Soviet points it proposes to serve. In Moscow, where the major fuel supplier is the Soviet Union, fuel payments would be made in rubles obtained through Latvian ticket sales. 3/

Baltia has provided letters from TWA describing the terms of its proposal to provide crew training and B-767 maintenance services at JFK Airport, and from Lufthansa confirming its capacity to provide maintenance services for the B-737 aircraft. Baltia states that all maintenance work would be performed under the supervision of Baltia's maintenance manager.

The applicant states that it expects to experience a load factor of 58.91 percent during the first year of service following initiation of operations on April 1, 1991. First-year unit costs per available seat mile are projected at 8.59 cents, and yield per revenue passenger mile at 15.24 cents. The applicant anticipates an operating profit of \$7.5 million for its first year of certificated operations.

Baltia has estimated its pre-operating expenses at \$4.9 million and its first-year total operating expenses at \$83.7 million. We have compared Baltia's forecast direct operating expenses with those recently reported by carriers operating the same type of aircraft and find that the applicant's projected direct operating costs per block hour (\$3,346) are above the average experienced by such carriers.

The Department generally expects a start-up carrier to have access to financial resources sufficient to pay its pre-operating costs plus a reserve to cover expected operating and administrative expenses for the first three months of operations in the event projected revenues are not forthcoming. In calculating financial resources, projected revenues are not considered. We have determined that Baltia will require start-up capital of at least \$26 million to meet our financial fitness criteria.

3/ Baltia would not currently be authorized to make ticket sales in the USSR for other than hard currency, and would likely be required to pay dollars for fuel in the USSR. However, pursuant to Annex 3, section V, paragraphs A and C of the US-USSR Civil Air Transport Agreement, Aeroflot, acting as general sales agent, would sell ruble tickets of at least 11% of the available capacity and pay the U.S. carrier in dollars.

The company's December 20 balance sheet shows that, thus far, Baltia has received \$56,000 in cash from an initial stock offering, about \$200,000 in kind from members of the management team, and about \$600,000 in organization costs contributed by the company's founding investors, management, and consultants. In addition, the applicant states that the Delaware Insurance Commissioner's Economic Development Fund (CEDF) has established a Latvian Trade Mission in Delaware in order to further its relationship with that country. Toward that end, the CEDF has provided letters confirming that it has deemed Baltia to be an eligible investment under this program and is promoting financing of \$50 million for the company from its subscribing insurance companies, to be paid on condition that it is selected to serve the US-USSR routes. Baltia states that it expects to receive approval from the insurance companies for the financing in early February 1991.

Based on the foregoing, we tentatively conclude that Baltia has developed a reasonable operating proposal and has a plan for financing that, if carried out, will generate resources sufficient to commence the operations proposed without posing an undue risk to consumers. However, before issuing Baltia an effective certificate authorizing it to conduct the proposed foreign scheduled passenger service, we will direct that the applicant provide a revised list of pre-operating expenses already paid and those remaining to be paid, plus evidence that the company has actually received sufficient funds to pay the balance of its pre-operating expenses plus working capital to sustain scheduled operations for at least three months, as discussed above.

Compliance Disposition

The applicant states that there are no actions or outstanding judgments against it, its key personnel or persons having a substantial interest in it. Baltia states further that there have been no formal complaints filed or orders issued in the past ten years finding any of these individuals or entities in violation of the Act and that no actions have been taken by the FAA nor have any charges of unfair, deceptive or anti-competitive business practices, or of fraud, felony or antitrust violations been brought against Baltia, its key personnel or persons having a substantial interest in it. We have checked the Department's records and found no compliance actions or consumer complaints against the applicant or any of its key personnel. The FAA has advised us that Baltia has begun the process of obtaining its operating authority under Part 121 of the Federal Aviation Regulations. The FAA states that it does not foresee any obstacles to the certification and that it knows of no reason why we should act unfavorably on Baltia's application.

We tentatively conclude that Baltia has the proper regard for the laws, rules and regulations governing its services to ensure that its aircraft and personnel conform to applicable safety standards and that acceptable consumer relations practices will be followed.

CITIZENSHIP

The Federal Aviation Act requires that certificates to engage in air transportation be held only by citizens of the United States as defined in section 101(16) of the Act. That section requires that the President and two-thirds of the Board of Directors and other managing officers be U.S. citizens and that at least 75 percent of the outstanding voting stock be owned by U.S. citizens. We have also interpreted section 101(16) to mean that, as a factual matter, the carrier must actually be controlled by U.S. citizens.

We tentatively find that the applicant is a citizen of the United States. It is a corporation organized under the laws of the State of New York, and over 97 percent of its voting stock is owned by U.S. citizens. Baltia has provided an affidavit attesting that its president and other officers and four out of five of the members of its board of directors are United States citizens. One board member is a citizen of Latvia and a member of its Parliament. Five other individuals who are citizens of the Latvian republics together own 2.76 percent of Baltia's stock and have been selected to serve the carrier in marketing and legal capacities in the Baltic region. There is nothing in the record that would lead us to conclude that control of this applicant is with non-United States citizens.

PUBLIC CONVENIENCE AND NECESSITY

On June 1, 1990, the United States and the Union of Soviet Socialist Republics revised their Air Transport Agreement to expand the civil aviation rights available to the carriers of both countries. The agreement provides, in part, that the United States may designate additional carriers to provide scheduled combination service from a point or points in the United States on a North Atlantic routing to Moscow, Leningrad, Kiev, Riga, Minsk, and Tbilisi. By Order 90-9-1, September 5, 1990, the Department concluded that certification of U.S. carriers to provide this service is consistent with the public convenience and necessity (Order 90-9-1 at 20). The Department also instituted the 1990 *US-USSR North Atlantic Combination Service Case*, Docket 47149, to select a maximum of three U.S. carriers to provide scheduled combination service between the United States and the Soviet Union on a North Atlantic routing. Baltia is an applicant in that proceeding.

EFFECTIVE CERTIFICATE CONDITIONS

If in this proceeding the applicant is found to be fit, willing, and able to conduct the proposed service, and if in the route proceeding it is selected to serve the USSR points, Baltia will be issued a certificate of public convenience and necessity authorizing it to engage in the proposed foreign scheduled air



transportation of persons, property, and mail. 4/ Consistent with our policy with respect to newly formed carriers, we will not make any such certificate authority effective until we receive evidence of Baltia's certification by the FAA as an air carrier authorized to conduct foreign scheduled passenger air transportation under Part 121 and evidence of liability insurance coverage that meets the requirements of Part 205 of our rules for all of its aircraft.

Moreover, section 401(r) of the Act requires that, once a company is found fit initially, it must remain fit in order to hold its authority. It is our experience that important changes often occur between the time when the Department first issues a fitness determination to a company and the time when that company receives the FAA operating authority necessary to have its economic authority made effective. To be assured that Baltia continues to meet our fitness standards, we will direct it to provide us, following its receipt of FAA authority, a statement describing any changes which it may have undergone since the issuance of this order, including any changes in its ownership, key personnel, compliance history, operating plans, or financial posture. We will also direct that the applicant provide a revised list of pre-operating expenses already paid and those remaining to be paid, plus evidence that the company has actually received sufficient funds to pay the balance of its pre-operating expenses plus working capital to sustain scheduled operations for at least three months. Any certificate authority issued to Baltia will not become effective until the Department has received these documents. 5/

Furthermore, to be assured that certificated air carriers continue to be fit after effective authority has been issued to them, we require that they supply information describing any subsequent substantial changes they may undergo in areas affecting fitness. Therefore, we will direct that, if Baltia is issued an effective certificate, should it subsequently propose substantial changes in its ownership, management, or operations, it must first file with the Department the information required in section 204.4 of the Department's Regulations. The compliance of the company with this requirement is essential if we are adequately to carry out our responsibilities under section 401(r) of the Act.

Finally, we remind the applicant about the requirements of section 204.8 of our rules. This section provides, among other things, that: (1) the certificate authority granted to a company shall be revoked if the company does not commence actual flying operations under that authority within one year of the date of the Department's determination of its fitness; (2) if the company commences the operations for which it was found fit and subsequently ceases

4/ Pursuant to section 801(a) of the Federal Aviation Act, the issuance of foreign authority to Baltia is subject to Presidential review.

5/ We also reserve the right to stay the effectiveness of Baltia's authority if any new information becomes available to us that warrants such action.

such operations for any reason, it cannot resume certificated operations unless its fitness has been redetermined; 6/ and (3) if the company does not resume operations within one year of its cessation, its authority shall be revoked for dormancy.

OBJECTIONS

We will give interested persons 15 days following the service date of this order to show cause why the tentative findings and conclusions set forth here should not be made final; answers to objections will be due within 10 days thereafter. We expect such persons to direct their objections, if any, to the application and points at issue and to support such objections with detailed economic analyses. If an oral evidentiary hearing or discovery procedures are requested, the objector should state in detail why such a hearing or discovery is considered necessary, and what material issues of decisional fact the objector would expect to establish through a hearing or discovery that cannot be established in written pleadings. The objector should consider whether discovery procedures alone would be sufficient to resolve material issues of decisional fact. If so, the type of procedure should be specified (see Part 302, Rules 19 and 20); if not, the reasons why not should be explained. We will not entertain general, vague, or unsupported objections. If no substantive objections are filed, we will issue an order that will make final the tentative findings and conclusions reached herein.

ACCORDINGLY,

1. We direct all interested persons to show cause why we should not issue an order making final the tentative findings and conclusions stated above;
2. We direct any interested persons having objections to the issuance of an order making final any of the proposed findings or conclusions to file them with the Documentary Services Division, Department of Transportation, 400 Seventh Street, S.W., Washington, D.C. 20590, in Docket 47037, and serve them upon all persons listed in Attachment A no later than 15 days after the service date of this order; answers to objections shall be filed no later than 10 days thereafter;
3. If timely and properly supported objections are filed, we will accord full consideration to the matters or issues raised by the objections before we take further action;
4. In the event that no objections are filed, we will consider all further procedural steps to be waived and we will enter an order making final our tentative findings and conclusions; 1/

6/ The carrier must file a notice of its intent to resume operations at least 45 days prior to said resumption. This notice shall contain updated fitness information.

1/ Since we have provided for the filing of objections to this order, we will not entertain petitions for reconsideration.

5. We will serve a copy of this order on the parties to Docket 47149 and the persons listed in Attachment A; and

6. We will publish a summary of this order in the Federal Register.

By:

Jeffrey N. Shane
Assistant Secretary for Policy
and International Affairs

(SEAL)

TESTIMONY BEFORE THE AVIATION SUBCOMMITTEE OF THE HOUSE
PUBLIC WORKS
AND TRANSPORTATION COMMITTEE

March 21, 1991

Daniel M. Kasper
Harbridge House, Inc.
11 Arlington Street
Boston, MA 02116
617-267-6410

March 21, 1991

Mr. Chairman and Members of the Subcommittee:

I appreciate your invitation to appear before this Subcommittee as part of your examination of important issues of U.S. international aviation policy.

I am currently the Director of the Transportation Practice at Harbridge House, Inc., an international management consulting firm with headquarters in Boston. Since joining Harbridge House, I have been responsible for a number of projects involving analysis of the airline industry. Clients for these studies have included U.S. airlines, airframe manufacturers, suppliers of a variety of goods and services to the airline industry, the Department of Defense, state Departments of Transportation, and several airport proprietors. In addition, I have published a number of articles, case studies, and books on various aspects of the airline industry. My analysis of the commuter airline industry was published by The Economist Press in 1987, and a second book, Deregulation and Globalization: Liberalizing Trade in International Air Services, was published by the American Enterprise Institute, as part of its Trade in Services Series.

From 1979 through 1983, I served at the U.S. Civil Aeronautics Board, first as Executive Assistant to CAB Member Elizabeth Bailey and from early 1980 until September of 1983, as Director of the Board's Bureau of International Aviation. Prior to joining the CAB, I specialized in the study of economic regulation and international competition while serving on the faculties of the Harvard University Business School and, before that, the University of Southern California.

My written testimony today consists of a paper I originally prepared for a conference sponsored by the American Enterprise Institute as part of its project on "The United States and Europe in the 1990s." The paper will be published later this year by AEI in a volume based on that conference, and I ask that in citing my testimony, appropriate acknowledgement be given to the American Enterprise Institute. I appear today on my own behalf as a long-time observer and student of international aviation, and the views I express are entirely my own.

U.S.-EUROPEAN AIR SERVICES IN THE 1990S:
A TURBULENT DECADE?

Prepared for the
American Enterprise Institute Conference On
"The United States and Europe in the 1990s"
Washington, D.C. March 1990
Revised January 1991

By:

Daniel M. Kasper
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Formerly Director of International Aviation
U.S. Civil Aeronautics Board

[Note: Quotations from this paper should be cited as follows: Kasper, "U.S.-European Air Services in the 1990's," published in Industry, Services and Agriculture: The U.S. Faces a United Europe, Barfield and Perlman, eds., forthcoming Summer 1991, American Enterprise Institute, Washington, D.C.]

Introduction

As the world enters the seventh full decade of commercial international air service and the final decade of the 20th Century, three major developments have become clear to all but the most myopic observers of international aviation:

- First, that the underlying economics of modern airline operations — particularly in an increasingly deregulated international marketplace — will result in the emergence of a relatively small number of global airline networks that will compete with each other in markets around the globe.
- Second, that the combination of airline industry globalization and drive toward European integration already have eroded beyond repair the foundations of the post-war international aviation regime.
- Third, that the resulting struggle to shape a new world aviation order is likely to result in turbulent aviation relations over the coming decade, particularly between the United States and the members of the European Community.

The paper will first review the economic factors that underlie the trend toward globalization and examine why they have rendered obsolete the international aviation regime that has prevailed since the end of World War II. It then will explore the initial jousting between the United States and Europe — principally the European Community — over the shape and content of a new regime for governing international aviation and how that struggle is likely to affect other nations. The paper concludes with an analysis of options available to U.S. and European aviation policy makers and some suggestions for constructing a new set of aviation agreements to replace the existing, bilaterally-based regime.

Deregulation and Globalization

Aviation developments in the United States have traditionally had an impact far beyond its national borders. Thus, it should come as no surprise to those familiar with the history of civil aviation that, when the world's largest aviation market and leading aviation power, reversed its 40 year old policy of economically regulating the airline industry, the reverberations of that change would be felt around the globe. And that is precisely what happened in the wake of a decision by the United States to economically deregulate its airline industry. Indeed, in important respects, commercial aviation in the 1980s can be best understood as the struggle of U.S. airlines to cope with deregulation and by the rest of the world's airlines — and governments — to cope with deregulated U.S. airlines. [FN: For a more detailed examination of these issues, see Kasper, *Deregulation and Globalization* (Cambridge, Mass.: American Enterprise Institute and Ballinger Publishing, 1988).]

Deregulation eliminated governmentally-imposed restrictions on entry, pricing, routing and other aspects of airline competition that had prevented or impaired competition in U.S. domestic airline markets. Freed of CAB control, airlines radically realigned their route structures, explored dramatically new pricing strategies, adjusted their aircraft fleets,

developed new approaches to marketing and distributing their services, and consummated a rash of mergers and acquisitions. The airline industry that emerged from the first decade of deregulated competition is characterized by a relatively small number (four to eight) of national — and increasingly international-single-carrier air transportation systems. The route networks operated by the surviving airlines typically consist of multiple, interconnected hubs, each served by frequent "feeder" flights from a large number of destinations. Management and coordination of the activities necessary to sustain these increasingly far-flung networks has been made possible by the use of a variety of powerful, computer-based information systems. The resulting U.S. airline networks appear to produce substantial economies of scale and scope comparable to those that characterize other multiproduct firms. [FN: Michael Levine, "Airline Competition in Deregulated Markets: Theory, Firm Strategy and Public Policy," 4 *Yale Journal on Regulation* at 393 (April 1987); also, E. Bailey and A. Freidlander, "Market Structure and Multiproduct Industries," 20 *Journal of Economic Literature* at 1024 (September 1982)]

Deregulation also had important effects internationally. The industry restructuring precipitated by deregulation strengthened U.S. airlines vis-a-vis their foreign competitors, particularly for traffic to and from the United States. Since foreign carriers generally lack the right to serve points behind their U.S. gateways (and, in most cases, could not economically provide such service even if they had the legal right to do so), they have relied traditionally on connecting service provided by U.S. airlines for access to non-gateway traffic in the United States. Prior to deregulation, U.S. domestic airlines were precluded from serving international markets while U.S. international carriers had only limited rights to serve the domestic market. As a result, U.S. domestic carriers had an economic incentive to feed traffic to foreign carriers and permitted those carriers to compete effectively with U.S. international airlines for non-gateway traffic.

But deregulation significantly changed the incentives of U.S. carriers to provide foreign airlines with connecting traffic from interior points and, as a direct result, weakened the competitive position of foreign flag airlines serving the United States. It did this by providing U.S. airlines with unfettered access to the entire domestic market which, in turn, made it possible for those airlines to serve many new markets. U.S. airlines quickly discovered, however, that only by adopting hub and spoke route systems could they provide economically viable service to the vast U.S. domestic market. Once they had established domestic hubs, it was a simple step for U.S. carriers to add service (i.e., new "spokes") to international markets using traffic collected at their hubs from the hundreds of U.S. cities. As a result, U.S. domestic carriers that had previously been happy to carry passengers to New York, Los Angeles, and other gateways for connections to foreign airlines, now sought to carry those passengers abroad on their own flights. Thus, deregulation and the economic logic of hubbing made international expansion by U.S. carriers virtually inevitable.

Deregulation also heightened the competition among U.S. airlines to attract and maintain the patronage of travelers, particularly frequent (i.e., business) travelers. As the rapid expansion of international trade and the trend toward globalization in other sectors of the economy stimulated the demand for international travel, an airline's ability to provide international service has become an increasingly important competitive factor even in domestic markets where a frequent traveler's choice may be affected by a desire to accrue

mileage in a single frequent flier program. Finally, deregulated U.S. airlines have sought expanded access to international markets because both traffic and profitability are forecast to grow at faster rates than in domestic markets.

Overall, U.S. deregulation has put foreign airlines under increasing competitive pressure from more, larger and increasingly efficient U.S. airlines. Plagued by small domestic markets, restrictive international agreements, and often inefficient airlines, other governments have adopted — sometimes reluctantly — market-opening measures affecting their domestic and international markets in an effort to replicate the efficiency and competitive benefits experienced by the deregulated U.S. airline industry. Thus, since 1978, numerous countries including the Canada, the United Kingdom, Japan, Australia, Taiwan, Korea and even the Peoples Republic of China have taken significant steps to deregulate or substantially liberalize the regulation of their domestic and, in some cases, international aviation markets. In addition, the European Community is now in the midst of a phased program that could result in substantially-deregulated airline competition throughout the huge internal EC market.

Meanwhile, foreign airlines in general and European airlines in particular have scrambled to keep pace with their U.S. counterparts, principally by means of either acquisitions or strategic alliances. To date, the major acquisitions have been entirely national; British Airways has acquired British Caledonian, Air France has taken over two French carriers, UTA and Air Inter, while Lufthansa sought to obtain control of the former East German carrier Interflug. Some partial acquisitions, in contrast, have been transborder. These include KLM's substantial minority stake in Northwest Airlines, SAS's equity stake in Continental, a three-way cross-ownership arrangement involving SwissAir, Delta, and Singapore Airlines, and Iberia's purchase of a large position in Aerolineas Argentinas. Although less active than European airlines, Pacific rim carriers have also taken equity positions in other carriers, including two in the United States — Japan Air Lines in Hawaiian and the Australian carrier Ansett in America West. In addition, the Australian carrier Qantas holds a significant stake in Air New Zealand.

European airlines have also been active in forming strategic alliances across national boundaries. SAS has taken the lead by entering a variety of such alliances, including agreements with airlines in the United States, South America, Europe and Asia. British Airways and United have entered a major "marketing" agreement that provides BA with improved access to interior points in the United States. (That agreement has been jeopardized by United's subsequent acquisition of Pan Am's rights to serve London.) Other examples of such alliances include the arrangement among SwissAir, Delta, Singapore, code-sharing agreements involving TWA and Austrian Airlines, American and Qantas, a number of other such agreements too numerous to mention.

The Withering Away of the Post-War Regime

International air services are governed today by the legal and institutional arrangements developed in the 1940's. Like the GATT regime that governs international trade in goods, the existing regime for international air services arose piecemeal from the failure of nations to agree on a more comprehensive, multilateral system. Thus, since the Chicago Conference on Civil Aviation in 1944 failed to reach a multilateral agreement governing the economic regulation of international air transport, air services throughout the world have been controlled by bilateral agreements between the nations concerned. The "Bermuda Agreement" negotiated by the United States and the United Kingdom in 1946 established what was then regarded as a relatively liberal pattern for the exchange of economic rights, but many of the agreements subsequently negotiated by other nations have been significantly more restrictive.

Following the adoption of an explicitly competitive international aviation policy in 1979, the United States began to use its economic clout and the promise of access to additional U.S. cities to negotiate significant liberalization of existing bilateral agreements. These U.S. efforts were particularly successful in Europe where the "carrot" of access to large, economically attractive markets and the threat of traffic diversion to carriers whose governments had signed market-opening agreements with the United States were sufficient to produce a series of new and substantially more liberal bilateral agreements.

But European carriers soon discovered that the strength of U.S. carrier hubs undercut the Europeans' ability to compete for non-gateway traffic. They have also made two additional discoveries: First, that the value of access to additional gateways in the United States diminished rapidly due to the fact that many cities generate insufficient traffic to sustain direct service; and second, that in order to compete with U.S. carriers for traffic to and from such interior points, foreign airlines might find it necessary to provide connecting services at their U.S. gateways to numerous interior points. Given the expense of acquiring and operating a fleet of aircraft sufficient, however, it would be economically infeasible to establish the capability to provide such connecting service unless the aircraft could also be used to serve the U.S. domestic market. In short, foreign airlines may need the right to serve the U.S. domestic market in order to compete effectively for international traffic to and from the United States. [FN: Because most national markets outside the United States are geographically small enough to be served effectively through a few gateways, U.S. carriers do not face a mirror image of this problem in serving most foreign markets. As discussed below, however, U.S. carriers face other, equally significant problems abroad.]

Foreign carrier access to domestic traffic, however, poses significant political and economic issues. To begin with, the United States and most other nations have enacted regulatory prohibitions against cabotage — that is, the carriage of domestic traffic by a foreign carrier. Moreover, even if these legal restrictions were eased to permit such access to be negotiated, the negotiators would still face formidable problems.

As described earlier, deregulated competition in the United States has demonstrated the importance of operating an widespread network of hubs, each supported by an array of feeder flights. Under deregulation, foreign carriers given access to the U.S. domestic market would be free to establish operations in the largest domestic market in the world, a market large enough to sustain operations on an economically efficient scale. U.S. carriers, in contrast, would typically receive access to foreign domestic markets too small to support efficient operations. Although the United States in theory could negotiate rights to carry traffic between pairs of European states, as a practical matter it would be impossible for the United States to negotiate bilaterally, for example, a set of agreements that provided U.S. carriers with significant access to internal European traffic. Moreover, unless European internal and domestic markets had been deregulated, U.S. carriers would be severely restricted in their ability to establish and sustain viable services in those markets.

Hence, conflicting domestic regulatory systems combine with small national markets to create a significant problem for U.S. and European negotiators under a regime based on bilateral agreements: While the internal EC market is roughly equivalent to the U.S. domestic market, providing U.S. carriers with access to the internal EC traffic is beyond the power of any single member state to grant. Thus, even if U.S. negotiators could grant access to the U.S. internal market, no single foreign government would be in a position to provide equivalent access for the United States.

Relations Between the EC and the United States

The increasing divergence in scale and scope between the size of economically-efficient airline markets and those defined by national boundaries has heightened interest — both in Europe and the United States — in the EC's efforts to establish a barrier-free internal market for air services. After all, if part of the air services problem lies in a disparity in market size between the United States and the rest of the world, cannot that problem be addressed by aggregating a group of smaller markets in to an equivalent bloc?

Although EC Member States have continued to negotiate bilateral air service agreements, they have done so in the absence of a Community air transport policy. Hence, the adoption of a Community air transport policy would undermine the continuing rationale for bilateral negotiations between individual EC Member States and third countries. Just as in the case of trade negotiations under the GATT, where the Commission already represents the EC member states, both the logic and the effective operation of a barrier-free internal air transport market ultimately require a common front for negotiating with third parties.

In fact, the Commission's Second Package of liberalization measures [FN: Commission of the European Communities, COM(89) 373 Final, 8 September 1989] already contains most of the elements of a common air transport policy. It also contains a number of elements that substantially increase the likelihood that the Commission will become directly involved in air service negotiations with the United States and probably other countries as well.

The Second Package specifically recognizes, for example, that a common EC air transport policy has "important implications for relationships between Member States and third countries" and reiterates earlier statements that EC-third country relations need to be based on the "principle of reciprocity" defined as "a guarantee of equivalent, or at least non-discriminatory, opportunities." In this context, the Commission specifically noted that "[I]t does not seem to the Commission that existing concessions to third countries in respect of fifth freedom between Member States (Community cabotage) are balanced by similar advantages abroad for Community air carriers." The impression that this comment appears to be directed primarily at the United States is reinforced by comments from a number of EC officials. In addition, EC officials regularly refer to an "imbalance" in the number of European cities served by U.S. airlines compared to the smaller number of U.S. cities served by European carriers. In view of these implications as well as the potentially significant impacts of third country bilaterals on the internal EC market, the Commission announced its intention to seek a mandate to negotiate with third countries "in appropriate cases."

The second aspect of the Package that is likely to precipitate greater Community involvement in air service negotiations with the United States involves fares. The Commission indicated that "it appears appropriate" to extend the Commission's fare regulations to cover domestic and third country fares as well as fares for services between Member States. Although not yet proposing such an extension of its jurisdiction, the Commission has pointedly noted that the European Court specifically affirmed the Commission's jurisdiction over such fares in the Ahmed Saeed case. [FN: Ahmed Saeed Flugreisen, European Court, April 11, 1989.]

The Commission's assertion of jurisdiction over fares will inevitably precipitate negotiations between the Commission and the United States (and possibly other states) because — if Member State jurisdiction over fares to/from the United States is supplanted by the EC — it would call into question existing pricing articles negotiated by the United States with various Member States. Since the United States negotiated those pricing articles in exchange for valuable routes and other rights, it is unlikely to accept changes in them without either additional compensation or a reduction in other rights presently enjoyed by community airlines. In short, the Commission's assertion of jurisdiction over fares between the EC and the United States will force the parties into a direct negotiation.

Third, the Second Package's proposed definition of a "community airline" [FN: Commission, *Ibid.*, Article 2 (c), Appendix D] specifically includes some carriers that are neither owned nor effectively controlled by nationals of Member States, thus permitting some — but not other — non-EC citizens to control existing airlines based in the Community. Such discriminatory treatment is likely to give rise to disputes with nations whose citizens are excluded.

Finally, the Commission has indicated that the citizenship and control provisions of existing Member State bilaterals are null and void with respect to citizens of the Community. [These standard bilateral provisions require that airlines designated by a signatory state be owned and controlled by citizens of that state.] Moreover, the Commission has "requested" that Member States "take the necessary steps" to bring their third country bilaterals into conformance with the Treaty's elimination of internal market barriers based on nationality. The stated intent of the Commission is to ensure "the right of establishment" throughout the European Community for community nationals.

The Commission's efforts to amend the citizenship and control provisions of member states' agreements with third countries is certain to precipitate negotiations between the Community and the United States. Since amending these provisions to meet the Commission's objectives would make it possible for any community airline to operate air services to the United States from the territory of any of the twelve Member States, U.S. negotiators are likely to require compensation before making such changes, a move that will trigger negotiations either directly with the EC or with its Member States as a group. In light of the difficulties encountered by the United States in dealing with a large group of European nations in the ECAC negotiations, U.S. negotiators may well conclude that American interests would be best served by negotiating directly with the European Community. [FN: For a discussion of the negotiations between the United States and ECAC member states, see Kasper, *Ibid.*, p. 75 et seq.]

Where We Go From Here

The Second Package of air transport proposals signifies an increasingly aggressive effort by the Commission to push European air transport toward a barrier-free market by the beginning of 1993. As a result of that effort, the odds are increasing that the EC will reach its goal by the mid 1990s if not by 1993.

Even without the Second Package, however, recent developments within the EC have substantially increased the likelihood that the United States and other non-EC nations will find it necessary to negotiate directly with the EC on air service matters. Both the establishment of Commission jurisdiction over external fares (in the *Ahmed Saeed* case) and the Commission's current efforts to amend the citizenship and control provisions of member state bilaterals with third countries are likely to impinge on existing U.S. bilateral rights and thereby precipitate direct United States-EC air service negotiations.

Moreover, the Commission is already preparing for third country air service negotiations with the European Free Trade Association (EFTA) countries and then with the other European states. It is clear that Community aviation officials expect (and want) the initial EC-third country negotiations to involve first the EFTA states, followed by "other European" nations (e.g., other ECAC member states); and, finally, by negotiations with the United States and other third countries. EC officials seem to believe that by sequencing negotiations in this fashion the EC will be able to put together a broader bloc of European nations, thereby strengthening their position in negotiations with North America and Asia. They seem particularly concerned about preventing the United States from utilizing a "divide and conquer" strategy in Europe.

Finally, the Commission appears to have in place at least the rudiments of a strategy for dealing with the United States in the air transport sector. That strategy can be summarized as follows:

- Force a rationalization of the European airline industry by increasing the level of competition.
- Negotiate first with non-EC nations to create both a Europe-wide aviation market and a larger economic bloc for negotiating with the United States (and Asia).
- Use the EFTA-EC negotiations to build the Commission's expertise and to develop mechanisms for utilizing the existing aviation expertise that exists at the Member State level.
- Convert internal EC and, if possible, European routes into cabotage routes to exchange for additional traffic rights in negotiations with the United States and Asia.
- Use the leverage from a common European front to get more access to the U.S. and/or restrict United States access to Europe.

It is thus a matter of when — not whether — air service negotiations will take place between the United States and the European Community. The more interesting question is whether either party will take the initiative in precipitating those negotiations or whether they will be forced into negotiations by pressures arising from rapid changes underway in the airline industry.

In my view, a "strategy" of waiting would be a mistake — for both Europe and the United States. By lessening the economic pressure on Europe to move rapidly toward liberalization, a wait-and-see approach may strengthen those in Europe opposed to a more open, competitive regime for air services. Without the threat of an active U.S. effort to further liberalize air services (and divert traffic from the airlines of illiberal nations), liberalization could be slowed not only across the North Atlantic but within the European Community as well.

Moreover, waiting for Europe to attain a common market is almost certain to delay U.S.-European liberalization past 1992 and may make European nations less willing to pursue broader liberalization in air services. The explanation for this is straightforward: It is simply not realistic to expect Europe to engage in substantial market-opening negotiations with the United States on the heels of bruising internal EC negotiations. And even if the European governments were willing, they could find it extremely difficult to get domestic support for trades with the United States that effectively unravelled compromises struck as part of the internal EC negotiations. Thus, by waiting for Europe, the United States, the Community, and the world could be faced with another odious CAP (this time a "Common Aviation Policy") by 1995.

Whether or not policy makers in the United States and Europe are prepared to act, recent events have significantly increased the likelihood of major changes in aviation policy. War in the Persian Gulf coupled with a recession have combined to deal a crippling blow to the world's airline industry by simultaneously raising airline costs while driving down traffic and revenues. The result has been to accelerate the already strong pressures toward greater industry consolidation — both in the United States and Europe. Since the outbreak of war in the Persian Gulf, two major U.S. airlines have sought the protection of the bankruptcy courts and another, Eastern, has ceased operations entirely. In Europe, the Commission has adopted some temporary measures designed to assist community airlines cope with the economic downturn. Nonetheless, Air Europe has ceased operations and virtually every other major European airline has announced draconian measures to cope with their deteriorating economic conditions.

Despite the stated intention of EC competition policy officials to "avoid the U.S. mistakes" in dealing with airline mergers, liberalization of EC air transport regulation is certain to lead to consolidation of the European airline industry. The current level of mating activity among European airlines suggests that most have already accepted the likelihood of significant liberalization in the internal EC market and are now acting on the (entirely reasonable) expectation that liberalization will lead to further industry consolidation.

Since Europe starts the process of liberalization with substantially fewer airlines than did the United States, however, the prospect of increased concentration in the internal EC air transport market poses difficult problems for the Community's competition policy enforcers. EC officials seem prepared to acknowledge that the existence of significant economies of scale and scope will lead to some increase in concentration with the European airline industry. Indeed, many believe that European airlines must become larger to compete effectively with American and Asian carriers in a global market.

But EC officials should also be troubled by the prospect that European airlines will use the specter of "U.S. giants" to create a tight oligopoly that dominates the internal market to the detriment of European consumers. In this regard, a number of recent and prospective agreements among European airlines should be particularly troubling to those interested in fostering a more competitive European aviation market. It remains to be seen whether the Commission will sacrifice a competitive industry structure in the pursuit of European "champions."

It will soon become apparent to EC officials — if it has not already — that, if reduction in the number of European airlines is inevitable, it may be more desirable from a competition policy perspective for some of the smaller European airlines to be acquired by non-Community airlines. Yet, under the Second Package's proposed definition of a "community airline," an airline from an EC member state cannot now be acquired by a carrier from a third country without losing its rights and privileges within the Community.

At the same time, policy makers in the United States also face a dilemma. Although the efficiencies of large networks can explain a substantial portion of the consolidation that has taken place in the U.S. airline industry, the combined effect of recession, war, and fuel cost inflation have had a particularly devastating effect on several U.S. airlines that had previously undertaken LBOs or other highly-leveraged financings. As a result, the United States must now deal with a situation in which the best way to preserve and enhance competition in its airline markets may be to permit foreign acquisition of weaker U.S. air carriers.

The United States appears to have recognized the potential of foreign investment. Thus, U.S. Secretary of Transportation Samuel K. Skinner recently announced a significant easing of restrictions on foreign ownership of U.S. airlines. [FN: U.S. Department of Transportation Press Release, DOT 09-91, January 23, 1991.] Moreover, in earlier approving investments in U.S. airlines by Swiss Air, KLM, Ansett, SAS and JAL, the Department has demonstrated some sensitivity to the importance of foreign investment and shown that a more liberal policy on foreign investment and control would not necessarily result in world domination by U.S. airlines. At a minimum, U.S. approval of investments in U.S. airlines by European airlines should mute opposition to comparable U.S. carrier investments in EC airlines. Should a U.S. airline seek to obtain more than a 25 percent interest in an EC airline, however, opposition could increase because of the 25 percent limitation on foreign ownership contained in the U.S. Federal Aviation Act.

Conclusion

For liberalization to proceed in the air services, it is clear that major changes will be required both in how negotiations are organized what is included in those negotiations. Neither change is likely to come easily.

To overcome the problem of disparate market sizes and domestic regulatory systems will require some aggregation of smaller markets into larger bargaining entities. The GATT is an obvious vehicle for reaching such an agreement, but certainly not the only one. Moreover, the application to air services of the GATT principles including unconditional most-favored-nation and national treatment would impede rather than enhance further liberalization.

A more promising approach would focus on securing a liberal agreement among an initially small group of air services powers with competitive airlines and market-oriented economies — a targeted multilateral. Such an approach is far more likely to produce a truly liberal regime for air services than is an approach based on the GATT. [FN: Kasper, *Ibid.*, p. 93 et seq.] Because such an agreement could cover such a large share of existing airline traffic, it could heighten the pressure on more restrictive countries to accept liberalization and reduce the ability of protectionist governments to dilute liberalization to the lowest common denominator.

For a variety of airline and political reasons, an agreement between the United States and the European Community is the most likely starting point for a targeted multilateral agreement. Both have large, well-developed internal air services markets. Moreover, as described earlier in this paper, recent EC initiatives are likely to require direct air service negotiations between the United States and the Community sooner rather than later.

Although U.S.-Community negotiations will not be easy, they will be far simpler than would talks among a larger, more diverse group of nations. Even among these relatively like-minded countries, however, governments will be required to make difficult, sometimes wrenching, changes in longstanding policies. In particular, governments will be required to put on the negotiating table items that have traditionally excluded from the bargaining. Thus, governments will find it necessary to permit the acquisition of existing airlines and the establishment of new ones to compete in their markets — in short, to give foreigners broad access to domestic and inter-regional markets. Governments will also have to accept the inevitability of acquisitions, mergers, and the multinationalization of airlines formerly viewed as national flag carriers and, in some cases, as extensions of the state. Inevitably, these changes will require governments to reduce or eliminate government subsidization and, eventually ownership of airlines.

Despite the formidable challenges facing U.S. and European Community negotiators, the failure to move ahead with liberalization could be costly. For if the United States and the Community cannot act quickly enough to replace the existing air services regime with one more suited to current and future conditions, the forces of change already at work in the world airline industry will surely find the "fault lines" in the existing regime and force a restructuring of that industry along the path of least resistance; such a restructuring is likely to be neither as efficient nor as open as a regime negotiated along the lines I propose.

It is now clear that air service negotiations between the United States and the European Community are inevitable and that the existing international regime governing air services cannot long survive. It is also clear that the United States and the Community are in the best position to negotiate a replacement regime that can provide a sound basis for the continued expansion of international air services. Under the circumstances, there is no valid excuse for either side to be unprepared for the task at hand.

REMOVING THE HOOSE FROM OUR CITIES' NECKS

Testimony of
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Washington, D.C.

on behalf of

UNITED STATES AIRPORTS
FOR BETTER INTERNATIONAL AIR SERVICE
(USA-BIAS)

Given before the
Aviation Subcommittee
Public Works and Transportation Committee
United States House of Representatives

March 21, 1991

REMOVING THE NOOSE FROM OUR CITIES' NECKS

I. Introduction

Mr. Chairman, Members of the Committee, ladies and gentlemen:

The international aviation regulatory system operates as a noose around our cities' necks, choking off needed economic growth. It is time to loosen that noose, or even remove it.

My name is Sam Keiter. I am Vice President International of Kurth & Co., Inc., aviation marketing and management consultants. Previously I served for 30 years in the United States Foreign Service, concentrating for the last ten of those years on aviation policy. My final Foreign Service position was as Director of Aviation Negotiations and Senior Aviation Policy Adviser at the Department of State.

Kurth & Co. has represented Baltimore/Washington International Airport, Kansas City International Airport, and occasionally other airports in USA-BIAS affairs, but today I am here for USA-BIAS as a whole. While the responsibility for what I say is mine alone, my intention is to reflect the views that USA-BIAS has adopted as a group.

What, you may ask, is USA-BIAS? The acronym stands for United States Airports for Better International Air Service, an informal coalition of U.S. communities dedicated to changing U.S. international aviation policy so that it facilitates the international air service and economic development we need, rather than choking it off.

We started in March 1989 with 8 members. Our only name was "The Gang of 8". Since then we have grown to 26 members in 22 states, as well as acquiring a more formal moniker. In general we are the hungry, second-tier of American airports, those whose communities need more direct international air service, but we range in size from Huntsville, Alabama, and Reno, Nevada, to Atlanta, Minneapolis/St. Paul, and Dallas/Ft. Worth. Together we account for more than one-third of all U.S. enplanements.

1. The members are listed in Attachment 1.

Let me emphasize that USA-BIAS works by consensus. Where members disagree with a particular USA-BIAS position they simply refrain from associating themselves with it. Thus the views I express today, while reflecting the weight of USA-BIAS opinion, are not necessarily shared by every member.

II. Why USA-BIAS?

USA-BIAS was formed because U.S. communities and their airports are no longer willing to put up with a U.S. international aviation policy that in practice puts the financial interests of U.S. airlines ahead of the wider interests of the nation as a whole. And that, despite some instances to the contrary, particularly around 1980, has been the usual state of affairs since the Second World War.

U.S. airports and communities were not even represented on U.S. aviation negotiating teams until 1983. Various other segments of the aviation industry, including labor, were, but it took quite a bit of doing for airports to get in the door. Even then, for a variety of reasons, community interests were rarely effectively represented.

USA-BIAS was created to change that state of affairs, and to a considerable extent it has. Our negotiators tell us that community interests are now factored into the formulation of U.S. negotiating positions and decisions, and we see signs in individual negotiations that this is in fact the case. In addition, the Department of Transportation (DOT) has established a Cities Program² which has truly broken new ground in allowing foreign airlines to provide service under certain conditions when U.S. airlines decline to do so. Despite these accomplishments, much more remains to be done, and we cannot afford to relax if we hope even to preserve what has already been achieved.

III. The Benefits of International Air Service

Before turning to USA-BIAS's specific objectives, I'd like to take a few moments to talk about just what U.S. communities have to gain from more and better international air service. It shouldn't really be necessary. Governments have recognized for centuries that transportation is the key to prosperity, and the United States Government in particular subsidized the creation of our railway system in the 19th century, and built an interstate highway network in the mid-20th century. Domestic aviation has been no different. From its earliest beginnings to the present day, subsidies have

2. By Order No. 90-1-62, issued January 30, 1990.

been given to support needed air transportation. When regulation was recognized in the 1970's as restricting aviation growth, it was removed.

Yet so far international aviation has been treated differently, and when communities claim that more and better international air service would mean major economic benefits they are asked for proof.

Until recently the evidence has been largely impressionistic. The available studies of the issue related to individual cities, or even individual air services. But last summer Kurth & Co. released Better International Air Service: Economic Base and Economic Benefits, a study commissioned by 11 USA-BIAS members to provide some more generally applicable quantitative support to our argument.³

The results of that study are impressive. Among other things, it shows that each new daily nonstop service with a widebody aircraft across either the Atlantic or the Pacific on a route previously without nonstop service will result in first year benefits to U.S. communities, primarily in the area of the U.S. gateway, of between \$260 and \$720 million. Let me say that again: Each new nonstop service where there was none before means between \$260 and \$720 million, 1/4 to 3/4 of a billion dollars, to the U.S. gateway concerned. Obviously, that's a lot of jobs.

And that's only in the first year. If we assume steady, moderate growth of 5% per year those benefits will double in 15 years and quadruple in 30 years, to 1 to 3 billion dollars per service per annum. If you add the benefits from all the services that would exist in an open environment over a few years, that's a lot of money, even by government standards.

The composition of those benefits varies with the proportion of travelers who are foreign visitors and the number of travelers, but visitor expenditures and their induced effects are always the largest component, accounting for roughly 40 to 60% of the total. Export expansion accounts for between 20 and 30%, even without taking any credit for induced effects, and foreign investment for 10 to 20%. The last 10% results from airline expenditures in the U.S. and the time savings of U.S. travelers.

Moreover, the study suggests that total U.S. benefits are roughly the same whether the service is provided by a U.S. airline or a foreign one. If it is a foreign one, additional visitor expenditures can be expected to offset the loss of

3. The executive summary of this study and two summary tables are at Attachment 2.

airline ticket receipts. And significantly, a new foreign airline service has no meaningful negative impact on U.S. carriers.

IV. USA-BIAS's Aims

As I indicated earlier, the achievement of more and better international air service for U.S. communities is more often than not entangled in the intricacies of individual bilateral negotiations. I will not try to address the details of any of them here. But USA-BIAS would welcome this Committee's support for the idea that U.S. aviation negotiators must take U.S. community and national economic interests fully into account, giving them precedence over airline and other aviation industry interests where communities and the nation have more at stake. In a free market economy like ours, economics, not regulators, should determine the winners.

Obviously, from our perspective amendment of Section 1102 (b) of the Federal Aviation Act to make the point would be ideal, and most permanent, but less formal support would also represent a major step forward.

USA-BIAS is currently focussing its efforts in three areas, and I would like to discuss each of them briefly. They are Canada, the general direction of international aviation, and the Department of Transportation's previously mentioned Cities Program.

A. Canada

The existing U.S.-Canada Air Services Agreement is a disgrace. It restricts service to relatively few routes, compared to those that would exist in an open regime, and it restricts competition on the routes where service is permitted. It was quite restrictive even by pre-1975 standards. In the days of aviation deregulation on both sides of the border and a U.S.-Canada Free Trade Agreement, it is antediluvian.

And it is expensive. We estimate that every first daily non-stop not instituted represents a first-year loss of \$120 million for the U.S. gateway concerned. \$120 million may not sound like much, but when you consider the potential for dozens of new routes and take normal growth into account, the total loss quickly reaches the billions.

Approaching the question from a different angle, another USA-BIAS study⁴ compared actual growth in U.S.-Canada air transportation with U.S.-Canada trade. It concluded that if air transportation had grown twice as fast between 1980 and 1989 as trade, the normal pattern, communities on both sides of the border would have had a total of \$9.3 billion dollars more economic activity in 1989. And of course the annual loss mounts as trade grows in each succeeding year. On top of that, better air transportation would mean even faster growth in trade.

These figures imply that moving to an open transborder aviation regime, one that allowed both U.S. and Canadian airlines to enter any transborder markets they wished, would result in an approximate doubling of transborder air transportation within a few years. Clearly airlines and airline labor on both sides of the border would be among the major beneficiaries.

The worst of the present situation is that the two countries came very close to a very open transborder regime in 1985. They had agreed that that was what they wanted. But Air Canada persuaded the Canadian Government it had to have fill-up rights in the United States, a limited form of cabotage, if there was to be an acceptable balance in airline benefits. In fact, those fill-up rights would have been of only limited benefit to Air Canada, and no threat at all to the U.S. and its airlines (which would have had similar rights in Canada), but on both sides defenders of the status quo were able to use the fill-up rights issue to keep agreement from being reached.

That was ridiculous, two major countries unable to make an important step forward because of a squabble over something that is truly insignificant.

Fortunately, as you well know, events have recently taken a turn for the better. Partly as a result of community efforts on both sides of the border, U.S. Secretary of Transportation Sam Skinner and Canadian Transport Minister Doug Lewis announced last October their intention to negotiate an open regime in which transborder flights would be "unimpeded by government economic regulation". Cabotage rights would be part of the discussion. Despite some bleats from special interests, that process seems to be moving forward.

4. U.S.-Canada Air Transportation: A Macro-Analytic Review, Leeper, Cambridge & Campbell, Inc., Alexandria, Va., November 9, 1990.

We understand that this Subcommittee has, quite naturally, taken an active interest in these negotiations, and has indicated that it will consider any Executive Branch request to amend the cabotage provisions of the Federal Aviation Act in this context on the basis of the overall national interest.

USA-BIAS welcomes these developments. We will be following the negotiations and related legislative activity closely, doing our best to ensure that negotiators and legislators alike give full weight to community and national interests in unimpeded transborder aviation.

B. Trends in International Aviation

Unfortunately, recent trends in international aviation more broadly have not been so favorable. The Thais, despite major economic benefits, have abrogated their liberal bilateral agreement with us. The French and the British, for different reasons, have successfully persuaded the United States to accept additional regulatory restrictions. The British even managed to get us to pay for the privilege.

We in USA-BIAS would like to take British declarations of intent to negotiate a more liberal bilateral in the near future at face value, but we have been too often disappointed in the past. Until British Airways and the British Government start mobilizing broad international support for the kind of regime they claim to desire, their declarations will be only empty words and excuses.

Unfortunately, the cure is far from evident. Partly at the urging of USA-BIAS, U.S. negotiators have offered open skies to all three of our major European aviation partners. The French said, "No"; the Germans are still dilly-dallying; and the British say, "Sure. Just as soon as you give us unlimited access to your internal market."

Maybe it would have helped if the U.S. had stood up to the British demands over Heathrow. How can we expect the Germans to adopt a still more liberal approach when the British have gotten more with vinegar than they have with honey? Surely our negotiators can find some way to demonstrate to our partners that in dealing with the United States a liberal approach to international aviation pays.

The basic problem is that the aviation authorities in most countries still see their role as protecting the interests of their national airlines. Those with a broader view are not much involved in setting aviation policy. Some of us in USA-BIAS thought that the negotiation of a General Agreement on Trade in Services might provide a dynamic for negotiating a multilateral open skies agreement, but, for a variety of

reasons, that now appears unrealistic. On another front, there is so far no significant evidence that a united Europe will have a more liberal international aviation philosophy.

C. Broadening the Cities Program

In the meantime, one thing that can be done is to expand DOT's program to expand international air service opportunities to more U.S. cities, the so-called Cities Program. As I indicated earlier, institution of the Program was an important initiative. By allowing foreign airlines to provide international service when U.S. airlines choose not to do so, it gives concrete expression to the principle that U.S. communities must not be held hostage to the interests of U.S. airlines.

But, not unnaturally, this initiative took cautious form, and the ability of foreign airlines to step in was restricted in a variety of ways, many of them inconsistent with the Program's underlying philosophy. Partly as a result, the Program has resulted in approval for just five services. One application was turned down because a U.S. airline planned to institute an inferior service within a few months, a service which will probably soon be abandoned. Don't misunderstand me: those five services are important, very important. But at the same time USA-BIAS believes that equally important services are being blocked by the Program's unnecessary restrictions. As a result, the Program's basic thrust, to provide needed service, is in many cases being thwarted.

Just which restrictions are unnecessary can be a matter of legitimate dispute, but I think we can all agree on this principle: When U.S. airlines choose either not to provide international air service between a particular U.S. city and a particular foreign city, or to provide inferior service, foreign airlines should be allowed to provide the service or the service improvement, at least if their homeland has a pro-competitive bilateral agreement with the U.S. Such a condition also offers foreign countries an additional incentive to accept and retain such agreements.

In practical terms, in USA-BIAS's view, that principle means amending the DOT Order establishing the Program to:

- 1) Make clear that only pre-existing U.S. carrier service of at least equivalent quality on the same city pair can block a proposed service under the Program. This both recognizes that different cities mean different markets, regardless of national borders, and, for example, prevents clearly inferior one-stop service from blocking non-stop service. (U.S. carrier plans would in addition be required both to pre-exist the application and to pass a public interest test.)

2) Remove all restrictions on advertising and carrying third-country traffic so long as the service operates no more often than daily. After all, the purpose of the Cities Program is to remove obstacles to needed service, not to create them.

3) Remove all restrictions on advertising and carrying third-country traffic in city-pair markets where pre-existing U.S. carrier service is inferior, regardless of frequency.

4) Remove the requirement that the foreign point served be in the foreign carrier's homeland.

5) Make the Program applicable to all-cargo services.

6) Remove the requirement to start service within 90 days of approval.

USA-BIAS would very much appreciate your Committee's support for these changes. I would be pleased to discuss the justification for each of them further at your convenience.

V. Conclusion

Mr. Chairman, Members of the Committee, international aviation is by definition "international", and the U.S. cannot impose its philosophy by fiat. But it can seek opportunities to put international aviation on a more economic basis, both in cooperation with willing partners, like Canada, and on its own, as through an improved Cities Program. USA-BIAS believes that its member communities, and indeed the United States as a whole, will benefit from the expansion of international air service, and it will continue to strive to ensure that that approach permeates U.S. international aviation policy. We hope that you will join us in that task.

Thank you for this opportunity to testify.

Attachments:

1. List of USA-BIAS members.
2. Better International Air Service: Economic Base and Economic Benefits, Executive Summary and two tables.

USA-BIAS MEMBERS

as of March 15, 1991

Atlanta	Minneapolis/St. Paul
Baltimore/Washington	Nashville
Charlotte	New Orleans
Cleveland	Newport News
Dallas/Ft. Worth	Orlando
Denver	Phoenix
Detroit	Portland, Ore.
Hartford, Conn.	Reno
Huntsville	St. Louis
Indianapolis	San Jose
Kansas City	Seattle
Las Vegas	Tampa
Memphis	Washington-Dulles

KC Inc. Aviation Marketing & Management Consultants

**BETTER INTERNATIONAL AIR SERVICE:
ECONOMIC BASE AND ECONOMIC BENEFITS**

Prepared For
U.S. Airports for Better International Air Service
(USA-BIAS)

June 1990

Kurth & Company, Inc.
4400 MacArthur Boulevard, N.W., Suite 303
Washington, D.C. 20007
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I. EXECUTIVE SUMMARY

This analysis, prepared for 10 members of U.S. Airports for Better International Air Service (USA-BIAS),¹ demonstrates the economic and other benefits of new nonstop international air service. It also shows that at present most of the participant airports' international service is not at all commensurate with either their service areas' population and buying power or their own role in U.S. domestic aviation.

A. The Benefits of International Air Service

A new daily nonstop service across either the Atlantic or the Pacific can be expected to result in measurable economic benefits to the United States, concentrated primarily in the U.S. gateway's local service area, of between \$260 and \$720 million in the first year.

These benefits are compounded by normal growth. For example, if growth is a steady 5% per year, the annual benefits will double in less than 15 years.

Visitor and airline expenditures alone, counting both direct and induced effects, will have a positive economic impact of between \$125 and \$500 million in the first year, depending primarily on the size of aircraft used on the route and the proportion of travelers who are foreign visitors.

Induced exports and foreign investment, plus direct time savings for American travelers, account for another \$140-220 million. In this case economic ripple effects have not been counted.

These estimates have been derived from an analysis of two hypothetical routes: first service to London (with a Boeing 767) and first service to Tokyo (with a Boeing 747). They do not apply directly to additional services in already served markets, even London and Tokyo markets.

1. The 10 are Baltimore/Washington, Dallas/Ft. Worth, Denver, Charlotte, Kansas City, Phoenix, Portland, Seattle, Tampa, and Washington-Dulles. In addition to these 10, Las Vegas' McCarran International Airport is also now a direct participant although their statistics are not reflected in this report.

On the other hand, the London results should not vary significantly from those of similar new service to other West European points, nor the Japanese results, after adjustment to reflect the smaller proportion of foreign visitors in other trans-Pacific markets, from those of similar new service to other points in Asia and the Pacific.

Analysis of comparable new service by U.S. carriers would show similar benefits. Operating revenues would of course flow to U.S. rather than foreign airlines, although in terms of national benefits that might be offset by foreign passengers' predilection to fly carriers of their own nationality. From a U.S. community and national economic point of view, the important issue is the attraction of additional service, regardless of carrier nationality.

B. Effect on Existing U.S. Carrier Services

First nonstop foreign airline services in markets that previously had to rely solely on connecting services (however described in computer reservations systems) are unlikely to have any significant impact on existing U.S. carrier international services. Numerous examples² show that, even in the short run, and even in markets with a U.S. incumbent nonstop, a first foreign flag nonstop ordinarily has only a minimal impact on U.S. carriers. The benefits of this new service are thus not gained at the expense of U.S. carrier traffic and revenue.

C. The Artificial Paucity of International Service

To estimate the degree to which international service at the participating airports has been restricted by government regulation, we compared their share of U.S. international enplanements with their share of U.S. domestic enplanements and their local communities' economic status relative to the rest of the country. The comparison suggests that their international service is only half what it might have been in a deregulated environment. Although the 10 airports for which data has been collected³ and their surrounding metropolitan areas collectively represent over 10% of U.S. Effective Buying Income and over 20% of U.S. domestic enplanements, they account for only 9.0% of

2. See page 16 below.

3. Because Las Vegas joined the group after the project was well under way, its data is not included here.

enplanements on flights going nonstop from the U.S. to a foreign destination.⁴

That 9.0% of nonstop international enplanements includes feed traffic. Since the 10 USA-BIAS airports' combined share of total U.S. international originating passengers (i.e., without feed traffic) is 9.4%, it is no surprise that while 69.3% of the airports' domestic originating passengers can fly to their final destination on single-plane direct service, only 47.9% at most of their international originating passengers fly direct to any international destination, let alone the final one. The other 52.1% or more connect to international flights at other U.S. gateways, with all the inconvenience and lost time which that involves. Still other potential international travelers undoubtedly simply do not travel at all in the face of these inconveniences.

It should be noted that the international air service which does exist at the participating USA-BIAS airports is heavily weighted in favor of U.S. carriers. While foreign flag enplanements in the U.S. as a whole represented 49.1% of total nonstop international enplanements in 1988, foreign flag enplanements accounted for only 36.6% of total nonstop international enplanements at the 10 airports examined, i.e., one-third instead of one-half.

D. Conclusion

This study's sponsoring communities (and probably many others, both USA-BIAS members and not) need and could support much more international air service than they now enjoy. Many important markets have no nonstop (or even same-plane) service at all. If regulators allow airlines, including foreign airlines, to initiate service in such markets, each daily trans-oceanic service will add roughly half a billion dollars a year to the U.S. economy, at little or no cost to incumbents serving other city-pairs.

4. Most of the participating USA-BIAS airports are large, efficient hubs, serving a much wider region than their immediate metropolitan areas, so it stands to reason that their share of U.S. domestic enplanements should be significantly larger than their share of U.S. population and buying power. Their share of U.S. international enplanements should also be significantly larger, roughly equivalent to their share of domestic enplanements. With reasonable service levels, it would be.

ESTIMATED ECONOMIC IMPACT OF INTERNATIONAL AIR SERVICE
VIA FOREIGN AIR CARRIERS:-----
B-767 Daily Service to London

SUMMARY: AVERAGE IMPACT AT 10 PARTICIPATING USA-BIAS AIRPORTS

VISITOR EXPENDITURES: \$30,653,293

(49,823 arriving passengers,
of whom 53.5% are foreign
citizens, at \$1,150 average
expenditure per visit
to the U.S.)

AIRLINE EXPENDITURES: 1/

Fuel and Oil	\$2,619,711
Food & Passenger Service	\$924,522
Advertising & Publicity	\$750,509
Traffic & Line Servicing	\$424,334
Payroll (avg. 10 employees)	\$372,448
Airport User Fees	\$356,929
Landing Fees	\$74,898

TOTAL: \$5,523,350

PRIMARY ECONOMIC IMPACT FROM
VISITOR AND AIRLINE EXPENDITURES: \$36,176,643

INDUCED DOWNSTREAM ECONOMIC IMPACT: \$90,441,608

(Employing multiplier of 2.5
to determine effect on
overall U.S. economy.)TOTAL PRIMARY AND INDUCED IMPACT FROM
VISITOR & AIRLINE EXPENDITURES: \$126,618,251

EXPORT EXPANSION: \$84,349,493

(49,823 arriving passengers,
\$1,693 in increased
manufacturing exports
per passenger.)

FOREIGN INVESTMENT: \$54,382,848

(Total investment of new
companies; estimated
payroll.)

TIME SAVED FROM NONSTOP SERVICE:

(49,823 round-trip passengers,
of whom 46.5% are U.S. citizens,
saving approx. 2 hours each way on
average, valued at \$25 per hour.)

\$2,308,985

TOTAL ECONOMIC IMPACT IN THE U.S.: 2/ \$267,660,423

1/ Airline expenditures shown here are an average of estimated
expenditures at 10 USA-BIAS cities.2/ For purposes of conservatism, total economic impact
calculated here does not include potential downstream
induced impacts of export expansion and foreign investment.

SOURCES: Tables I-B - I-J.

ESTIMATED ECONOMIC IMPACT OF INTERNATIONAL AIR SERVICE
VIA FOREIGN AIR CARRIERS:

B-747 Daily Service to Tokyo

SUMMARY: AVERAGE IMPACT AT 10 PARTICIPATING USA-BIAS AIRPORTS

VISITOR EXPENDITURES: \$127,070,732

(96,324 arriving passengers,
of whom 83.6% are foreign
citizens, at \$1,578 average
expenditure per visit
to the U.S.)

AIRLINE EXPENDITURES: 1/

Fuel and Oil	\$9,883,723
Food & Passenger Service	\$2,197,648
Advertising & Publicity	\$2,003,416
Traffic & Line Servicing	\$779,602
Payroll (avg. 10 employees)	\$372,448
Airport User Fees	\$356,929
Landing Fees	\$148,219

TOTAL: \$15,741,984

PRIMARY ECONOMIC IMPACT FROM
VISITOR AND AIRLINE EXPENDITURES: \$142,812,716

INDUCED DOWNSTREAM ECONOMIC IMPACT: \$357,031,790

(Employing multiplier of 2.5
to determine effect on
overall U.S. economy.)TOTAL PRIMARY AND INDUCED IMPACT FROM
VISITOR & AIRLINE EXPENDITURES: \$499,844,506

EXPORT EXPANSION: \$163,075,686

(96,324 arriving passengers,
\$1,693 in increased
manufacturing exports
per passenger.)

FOREIGN INVESTMENT: \$54,382,848

(Total investment of new
companies; estimated
payroll.)

TIME SAVED FROM NONSTOP SERVICE:

(96,324 round-trip passengers,
of whom 16.4% are U.S. citizens,
saving approx. 2 1/2 hours each way on
average, valued at \$25 per hour.)

\$2,044,376

TOTAL ECONOMIC IMPACT IN THE U.S.: 2/ \$719,348,262

1/ Airline expenditures shown here are an average of estimated
expenditures at 10 USA-BIAS cities.2/ For purposes of conservatism, total economic impact
calculated here does not include potential downstream
induced impacts of export expansion and foreign investment.

SOURCES: Tables II-B - II-I.

STATEMENT OF JAMES E. LANDRY
SENIOR VICE PRESIDENT AND GENERAL COUNSEL
OF THE AIR TRANSPORT ASSOCIATION OF AMERICA
CONCERNING INTERNATIONAL AVIATION POLICY AND BILATERAL AGREEMENTS
BEFORE THE SUBCOMMITTEE ON AVIATION
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
U.S. HOUSE OF REPRESENTATIVES
MARCH 21, 1991

The Air Transport Association of America (ATA) appreciates this opportunity to participate in the Subcommittee's timely review of international aviation policy and bilateral agreements. We commend you for setting this subject so high on your agenda in the early months of the 102nd Congress, because you are implicitly reminding all of us in the aviation community that the decade of the 1990's is likely to become the watershed decade in international aviation policy-making. We hope that the cumulative record of this and future explorations of the course our government and our airlines should chart will fully elucidate the great challenges, the potential pitfalls and, above all, the enormous opportunities which lie ahead.

As you know, ATA is the trade and service association of the U.S. airline industry. Our 20 operator members collectively account for over 96% of the revenue passenger miles that scheduled airlines operate in this country, and roughly the same percentage of the industry's freight traffic. Sixteen of those carriers provide the lion's share of U.S.-flag international air transportation service, operating to some 74 countries around the globe. The great bulk of that service is enabled by a sophisticated network of 72 bilateral air transport agreements, negotiated and refined by governmental delegations with, and sometimes against, advice from the private sector, over the past 45

years. The total of 72 bilaterals, incidentally, grows to 95 if you count the newly independent nations which have formally agreed to adhere to the provisions of pre-independence agreements between the United States and the previous governing powers.

On balance, from the U.S. airlines' perspective, that bilateral approach has been successful. The latest DOT international air travel statistics available, reflecting the total passenger traffic to and from this country during the 12-month period ending with October of last year, reveal that U.S. flag carriers garnered 52% of that traffic. That means, of course, that we do better than that in some markets in head-to-head competition with foreign flag airlines and, commensurately, we do worse than that in some others. Recognizing that U.S. citizens unfortunately have not historically shown the same propensity for "following their flag" as have nationals of other countries, a 52% share of a total market that was comprised of 55% citizens, 45% aliens, is, arguably, adequate, but -- needless to say -- one which our airlines are strongly determined to improve.

Most importantly, the traffic pie being shared has been growing at a much higher rate internationally than domestically, particularly in the last four years. For example, U.S. scheduled airlines in 1990 realized a 12% growth from the 1989 level in international enplanements, as contrasted to a 1.8% growth in domestic enplanements. And, for 1989 over 1988, the comparable figures were plus 5.5% and minus 0.7%; 1988 over 1987, plus

14.8% and plus 0.6%; 1987 over 1986, plus 23% and plus 5.8%. Moreover, the same has been holding true, except for last year, with regard to air cargo. Last year we saw a 3.1% growth in international cargo ton miles versus a 3.3% growth in domestic cargo ton miles. But, prior to that, the growth rates were 11.9% versus 1.5% in 1989, 22.2% versus 11.6% in 1988, and 16.9% versus 8.8% in 1987.

All of that is, of course, a testimonial to the dynamic effects of the liberalization of aviation policies and laws worldwide, and the competitive capabilities of today's airlines -- not merely to the improvements in our bilateral regime. But it does strongly suggest that the bilateral system is not dead, as some of the experts may tell you. Rather, we would suggest, the political and socio-economic developments in some regions of the world make it likely, perhaps inevitable, that the sophisticated network of bilaterals which I mentioned will be complemented by one or more regional multilaterals before the end of the century. And traffic will resume and continue its impressive growth, after the hiatus occasioned by the hostilities in the Persian Gulf. And, provided that our policy-makers and negotiators insist upon a fair balance of opportunities across the negotiating tables and a full implementation of the rights and privileges we obtain, a healthy, vigorously competitive group of U.S. flag airlines will carry an ever-growing share of that burgeoning international traffic.

Some observers today must feel that the exciting suggestions

of open skies and expansive swaps of -- not two, not five, but now seven freedoms of the air in the latest U.S.-U.K. exchange -- is all new, a creature of the 1990's, so to speak. Not true. It is often sobering to look back on where we have been; in the case of international aviation policy, that is particularly true. If you go back to the reports of the historic Chicago Conference in 1944, which in 37 short days produced the landmark civil aviation treaty, the so-called Chicago Convention, you will find the following impassioned plea by a U.S. delegate, Mayor LaGuardia, at a plenary session: "What we are to do is to open the skies to provide this freedom of access, the freedom of flight to all planes of all countries to all parts of the world." And he went on: "Are we going to give just one little ray of hope to the fighting men of the world, to their families, that we are really establishing a new order in this world? Are we really with our action going to put into effect the possibility of free travel, free transit of goods? That's why I don't want to fail."

Bold words. Bold visions. But, as we all know, that was not to be the success story of the Chicago Conference. Despite the vigorous efforts of some -- the U.S. delegation in particular, the multilateral attempt to exchange traffic rights for virtually unrestricted services along reasonably direct routes from a carrier's homeland to the territories of other contracting nations was destined to fail.

Reconciled to its failure, the United States and other nations

began in 1946 to pursue the negotiation of bilateral undertakings, reflecting the widely varying attitudes of pairs of partners toward the desirability of unfettered competition in the air transport markets involved. The international system that has evolved since Chicago is pervasive and, in large measure, a success in meeting the needs of a demanding public. From the U.S. vantage point, our 72 bilateral agreements are based on one enduring principle -- "a fair and equal opportunity for the carriers of the two nations." Not an artificial division such as a 50/50 split of the market involved -- the restrictive concept first adopted by a large portion of the world aviation community, but rather an opportunity for the carriers of one country to gain as much benefit from the overall exchange as the carriers of the other country. The opportunity, in short, to compete -- not to hold the promotion and development of a market to the capabilities or desires of a lowest common denominator.

No system is perfect. Some of our bilateral partners have refused to rely on the market-place to spur traffic growth, some have imposed or permitted artificial barriers to our carriers' ability to do business abroad to effectively deny us the rights we have traded for. But, on the whole, our industry has fared reasonably well -- as noted previously, we continue to carry the majority of the traffic to and from our country -- still the world's richest aviation market. And commercial airline services make a positive contribution to the U.S. balance of trade.

The failure of the quest for a multilateral in 1944, and the turn to the development of a multilateral regime in 1946, did not by any means signify that the issue was dead. It was addressed again in 1947 by the International Civil Aviation Organization (ICAO), in 1957 by the European Civil Aviation Conference (ECAC), tentatively by ICAO again in the early 1960's, but most actively and ominously, as this subcommittee well knows, during the Uruguay Round of the General Agreement on Tariff and Trade (GATT) talks over the past four years. Throughout this period, we believe our government has wisely adhered to a position first enunciated by the Truman Administration in 1948: i.e., routes should be exchanged bilaterally, with only the operational and technical principles being established multilaterally. That horizon was subsequently somewhat broadened, in 1954, by the Eisenhower administration's statement of U.S. civil air policy, declaring that: "The exchange of air transport rights will continue to be by bilateral air transport agreement until such time as it is possible to achieve a multilateral agreement which contains principles generally in accord with those of existing United States bilateral agreements."

With some short-lived vacillating through the years, both our government and we in the airlines have remained wedded to the bilateral approach, reflecting the factually sound conclusion that the United States, and in particular the U.S. airline industry, would be the losers if we were to become party to a universal multilateral accord. The soundness of this determination has never

been more eloquently demonstrated than it has over the last few years, as we all considered the potential impact of including air transportation in a proposed General Agreement on Trade in Services (GATS), during the Uruguay Round.

As you, Mr. Chairman, other members of this subcommittee, and others throughout the Congress immediately recognized, the application of the GATT principles of most-favored-nation (MFN) and national treatment alone would mean a dismantling of the bilateral system. Adoption of the MFN principle would utterly destroy the delicate balance of opportunities we have struck in the bilateral negotiating process through the years. And, application of the principle of national treatment would repeal the cabotage prohibition for foreign carriers of all flags, in one dramatic sweep, with no commensurate return. In short, the economic viability of our industry would be placed in immediate and constant jeopardy.

Moreover, both existing and proposed GATT dispute settlement procedures are anathema to time-tested approaches for resolving aviation controversies under bilaterals and U.S. laws. As you well know, the existing GATT procedures are agonizingly slow and cumbersome, and the eventual dispute resolution is unenforceable. The proposed dispute settlement concept would, on the other hand, entail what is called "cross-linkage," i.e., retaliation or remedies trading off one service sector against another, or services against goods. In short, trading aviation rights for

soybeans...or cognac...or shoes.

Again, we thank this Committee for weighing in so heavily and effectively on this issue last year, and we urge you to take all steps necessary to assure our effective exclusion from any GATS agreement, in the event fast-track authority is extended for two years, as the President has requested.

Assuming that the future will not bring the tragic mistake of placing air transportation services under a GATS accord, what do recent and on-going developments realistically portend? First, as Secretary Skinner and Canadian Minister of Transport Lewis have announced, we will soon launch the effort to revamp the outdated, restrictive and inefficient U.S.-Canada bilateral agreement. As the Secretary and Assistant Secretary Shane have since declared, everything -- with the notable exception of foreign ownership -- will be on the table in those discussions; the intent is to have these negotiations be the crucible for testing such concepts as open skies, and cabotage rights. It is fortunate, I believe, that we are still seeing a necessity for more homework by the European Community (EC) in advance of any more massive undertaking such as the prospective US-EC negotiations or even, hypothetically, EC-North America negotiations.

To ascertain where we want these critical future negotiations to take us, it is imperative to bear in mind that the one constant is our desire for a balance of opportunities. If, in order to achieve that in a dramatically expanded agreement, some measure of

cabotage rights is necessary to balance the scales, I suspect it will come. At least, our member airlines would be prepared to consider it in an appropriate U.S.-Canada package. But, it takes no crystal ball to foresee that the initial opening would be in some form of "limited cabotage" and that any dose of protection for Canadian carriers for a transitional period would have to be just that -- temporary and transitional. If these talks are to establish any precedent, let it not be bad precedent!

We do hope that the negotiating teams from our two great nations will seize this unique opportunity to propel U.S.-Canada aviation relations to a position comparable to that already reached or within reach of the 12 member states of the European Community in some areas. We hope, for example, that these talks inspire the genesis of a joint North American passenger inspection process, looking to the day when entry into one country by travelers from outside our continent is entry into both countries, and U.S. and Canadian citizen traffic can flow freely, cleared by an unduplicated staff of inspectors from either nation.

When we spoke of an approaching watershed for international aviation policy, we did not, of course, confine our vision to the hopefully wholesale expansion of the U.S.-Canada bilateral agreement. In addition, it is clear that the world-wide evolution of civil aviation laws and policies which was arguably triggered by, or at least given its initial momentum by the Airline Deregulation Act, has brought a new focus to the issue of

multilateralism, or at least the concept of regional multilaterals. The resolute, albeit not currently swift movement of the European Economic Communities toward a Single European aviation market, hopefully with pro-competitive directives both internally and externally, portends a day when the United States, or as I said perhaps even the United States and Canada, will negotiate with a multilateral grouping of like-minded European nations.

Nor is that the only potential deviation from the traditional bilateral framework. Citing our long-standing agreement with the Scandinavian countries as an example, some have suggested that aviation realities and partner countries' views may well permit a multilateral approach to exchanging rights with other regional groups of nations. Central America, Eastern Europe, the Southeast Asian countries, and the addition of other countries to the Scandinavian group have been cited as possibilities.

In the forefront of everyone's mind, after the Canadian negotiations, lies the challenges and opportunities posed by EC-92. Once the European Community's house is in order -- or will it be the European Economic Space's house or ECAC's? -- we will be likely to initiate negotiations for a major, expansive exchange of aviation rights. Actually, the apparent trend toward a trans-Atlantic multilateral, at least with the United States, should come as no surprise. As I have noted earlier, the Subcommittee should bear in mind the fact that the cornerstone of U.S. international aviation policy has always been "a fair and equal opportunity" for

carriers of both sides to compete -- a fair balancing of market opportunities. For its part, the cornerstone, general negotiating directive of the E.C. Commission's recommendation for the opening of negotiations between the EC and the European Free Trade Association (EFTA) countries was that agreements on scheduled air passenger services be concluded between the Community on the one hand and Austria, Finland, Norway, Iceland, Sweden and Switzerland, on the other hand, based on the principle of a fair balance of market opportunities. As an interim step, the same general objective guided the EC's initial, more limited negotiation with Norway and Sweden.

Moreover, from the U.S. perspective, it has long been recognized, and indeed explicitly enunciated in the 1954 policy statement, that a time may come when "it is possible to achieve a multilateral agreement which contains principles generally in accord with those of existing United States bilateral agreements." It would thus seem that, at a minimum, the ingredients for a successful regional multilateral agreement between the United States and the EC, or some other group of European nations, are in place.

Fortunately, responsible governmental officials on both sides of the Atlantic -- EC Commissioner of Transport Van Miert and Assistant Secretary of Transportation Shane -- have asserted that operating rights held as a result of bilateral trading over the past 45 years will be maintained, and will provide the foundation

for further multilateral expansion. That is a sine qua non. If, but only if, the rights we have obtained across many bilateral negotiating tables, sometimes at a heavy price, are honored and no one expects us to pay again for those rights, we can and will jointly build upon them. The increments can and must be added in further adherence to our common, overriding principle -- a fair balance of market opportunities -- a fair and unfettered opportunity to compete.

Let me also take this opportunity to dispel one myth which may have developed as a result of some bellicose rhetoric in some European quarters. Some would have you believe that, in the aggregate, the rights now held heavily favor the United States, particularly because of perceived Fifth Freedom opportunities. Let the facts be understood by all those who make such assertions -- there is far less there now for the United States than meets the eye.

In total, U.S. carriers exercise Fifth Freedom rights between only 9 of the 29 EC city-pairs with an annual one-way passenger volume of over 50,000, and between another three city-pairs with passenger volumes below 50,000. Moreover, our nine U.S. carriers currently serve a total of 24 EC cities with access to 66.6 million people, or 20% of the EC population. In contrast, a total of thirteen EC carriers collectively enjoy rights to operate to 22 U.S. points with access to 77.1 million people, or 36% of the U.S. population. Indeed, the flag carriers of most EC countries

currently have access to U.S. markets in excess of the total populations of their respective homelands. And all of the figures that I have just cited reflect the exchanges in place last year, long before the recent mega-swap with the United Kingdom.

In short, the scales are not tipped in our favor now. With that understood, we look forward to working together with our European friends to dramatically expand the trans-Atlantic market, consistent with our common primary objective -- a fair balance of market opportunities.

Before closing, Mr. Chairman, I should note that when I had the privilege of testifying before this subcommittee a month ago, I said that the industry had reached a tentative consensus that the traditional restrictions upon the level of foreign ownership of U.S. airlines should be relaxed, but that we had not arrived at any definition of how that should be accomplished. I promised to report to this Subcommittee when and if we had reached a final consensus and could offer a definition. Since that time, it has been decided that the carriers will continue to respond individually to foreign ownership initiatives as they arise.

In that same appearance before this Subcommittee, I also urged that Congress take quick action to fill a critical gap in the war risk insurance coverage authorized under Title XIII of the Federal Aviation Act, and to correct some other practical shortcomings of those 20 year old provisions. Fortunately, General Schwarzkopf and the valiant men and women under his command have substantially

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reduced the urgency of that legislative action. But you in particular, Mr. Chairman, know how swiftly that coverage can be needed in times of hostilities or, indeed, if terrorists should once again strike out against civil aviation. We therefore urge you to make sure that the remedial legislative amendments are in place when and if they are ever needed.

Likewise, Mr. Chairman, when I appeared before you last month, I also mentioned our serious concerns regarding the Department of Agriculture's discretion in setting a user fee on international airline passengers that would cost the passengers millions of dollars more than the amounts needed to fund the costs of the inspection services provided to the passengers. Our worst fears have been realized in the NPRM issued by the Agriculture Department on February 27.

Without justification, Agriculture shortened the required comment period to two weeks, and mandated an automatic effective date of April 1 (just two weeks later), to begin collecting the fee. This NPRM, with such a vast impact on the otherwise financially troubled airline industry, should at the minimum, be withdrawn and reissued under the requirements of the Administrative Procedure Act.

The imminent effective date for the fee will create inordinate administrative burdens for the airlines and travel agents who will have to gear up without any advance notice--extensive computer programming involving hundreds of man-hours is required to input

the information in airline and travel agent ticketing systems. Agriculture also used the NPRM to create a new user fee on domestic traffic in Hawaii and Puerto Rico. This new fee on domestic travellers vastly complicates the collection process and creates new administrative burdens since such a fee has no precedent.

Finally, this fee, set by Agriculture at \$2.00 per passenger, will bring in \$79 million dollars, far in excess of the amounts needed to fund the APHIS costs of \$43 million dollars (as contained in their NPRM). Therefore, they should reassess the amount of the fee and reduce it to \$1.00 in accordance with the 1990 law that authorized the fee to cover their costs, and nothing more.

In conclusion, then, what does our crystal ball foresee happening to the inter-governmental infrastructure for the international air transportation system in the 1990's? A continued evolution in the negotiating process, producing a mixture of expansive bilateral and regional multilateral accords, rather than an abrupt and inappropriate opening of the floodgates as would be entailed by the inclusion of the air transport sector in the proposed General Agreement on Trade in Services.

We assure you that the U.S. airline industry will fully support that development, provided that the agreements do indeed promise a balance of market opportunities and thus entail no economic payment for an international political goal, and provided that no artificial barriers are constructed or retained which thwart the fair exploitation of those opportunities. We cannot

over-emphasize that last point -- we urge this Subcommittee, in its critical oversight role, to continue to insist upon not just a paper exchange of competitive opportunities, but also a full honoring of concrete commitments to their enjoyment.

Thank you once again for the opportunity to discuss the future course of our international aviation policy with you. I will be pleased to respond to any questions you may have.

AIRPORT OPERATORS COUNCIL INTERNATIONAL



**STATEMENT OF THE
AIRPORT OPERATORS COUNCIL INTERNATIONAL**

on

**INTERNATIONAL AVIATION POLICY
AND BILATERAL AGREEMENTS**

**Before the
Subcommittee on Aviation
Committee on Public Works and Transportation
U.S. House of Representatives**

March 21, 1991

**Barney C. Parrella
Senior Vice President
Economics & International Affairs
Airport Operators Council International**

AOCI represents the local, regional and state governing bodies that own and operate the principal airports served by scheduled air carriers in the United States and throughout the world. AOCI's member airports enplane more than 90 percent of the total domestic and virtually all international scheduled airline passenger and cargo traffic in the United States.

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(First line of message should read: "MAILBOX TO AOCI")**

Testimony of the Airport Operators Council International (AOCI)Before the House Aviation SubcommitteeMarch 21, 1991

Mr. Chairman and members of the Subcommittee, my name is Barney Parrella. I am Senior Vice President, Economics and International Affairs, for the Airport Operators Council International (AOCI). It is my pleasure to appear before you at today's hearings on U.S. international aviation policy and bilateral agreements, and to present to you the views of the U.S. members of AOCI on these matters. AOCI represents the local, regional and state governing bodies that own and operate the principal airports served by scheduled air carriers in the United States and throughout the world. AOCI's U.S. member airports enplane more than 90 percent of the total domestic and virtually all international scheduled airline passenger and cargo traffic in the United States.

We commend you, Mr. Chairman, for continuing to hold oversight hearings on the important subject of international aviation, and for your leadership in aviation as we try to shape the future of this sector of the global economy.

As the governmental entities at the state and local level with the most direct involvement in aviation, U.S. airport operators have a keen interest in the directions and trends of the aviation industry, and government policies and practices affecting aviation.

In their dual role of proprietor of aviation facilities and catalyst for regional economic development, airports have become increasingly active in promoting and protecting their interests in aviation matters.

This activism has become particularly focused in recent years in the area of international air service. Over the past decade, U.S. airport operators have participated directly in the U.S. international air service process as observers on the U.S. negotiation delegations. The AOCI U.S. Bilateral Program provides a means through which the views and interests of U.S. airport operators are conveyed to the U.S. negotiators, and the progress of the negotiations are reported back to the interested airport operators. With some 68 participants, the Program has achieved an important and continuing level of contact and interaction between the community interests and the negotiators at the table.

International aviation is strictly regulated by national governments and restricted by various bilateral international agreements. The structure of many of these agreements limits the opportunities for air service expansion to piecemeal additions to or extensions of existing routes and services. As a result, the opportunities and benefits to communities which flow from better access to the global economy tend to be severely restricted.

United States communities of all sizes, locations and circumstances are seeking to

enhance the quality of their international air service: communities with strong origin/destination markets that are experiencing continued growth; communities with strong tourism and leisure markets; communities with strong business travel demand; communities with demonstrable untapped potential for more direct international air service; communities seeking a more diverse range of competitive air service options for travelers and shippers; communities with specialized market characteristics; and communities with combinations of these characteristics.

The diversity and multiplicity of communities having an interest in these matters often results in competition among them for the particular new or expanded services which are on the table during the negotiations. This competition points to the underlying inadequacy of rigidly defined and inflexible bilateral agreements as a means of identifying and satisfying market demand. Communities get caught in the middle of a zero sum game. They know that the new or expanded rights that will come out of the negotiations will be very limited, and that this will be, in all probability, the last opportunity for expansion in that particular market for years to come.

Out of this diversity of community interests and frustration with business as usual comes a common denominator among U.S. communities and airports: the provision of international air services should, to the maximum extent possible, be determined by the interplay of market forces. Government restrictions on the commercial decisions of air carriers should be kept to the minimum necessary to achieve such public interest

objectives as safety, security and environmental protection. Liberalization of the air transport regime is the objective we urge all governments to seek.

Bilateral route rights have historically been "exchanged" based upon agreement by both sides that a "balance of benefits" has been achieved. Traditionally, that assessment has been based largely on the impacts on and opportunities for air carriers. Only recently have these assessments begun to show a recognition that community interests should be afforded substantial consideration within the priorities of the bilateral negotiations, and in the subsequent decisions on route transfers and replacements.

The air traffic in a market is largely the result of the economic market base of the communities at each end of the route. The airline that provides the service has, of course, a commercial interest in the economic success of its service. That airline does not, however, have a right to the traffic in the market in which it operates. Traffic springs from economic activity in the communities and regions, in the catchment areas of the nation's airport operators. This fact alone justifies the conclusion that community interests should be given at least equal, if not greater, consideration than that afforded air carriers in governmental consideration of how air traffic demand should be met.

We applaud recent efforts by the Administration to open up international markets and take a broader view of air service development. Secretary Skinner's "Cities Program," whereby exemption authority can, under certain circumstances, be granted to a

willing foreign air carrier in international markets lacking non-stop or one-stop/single-plane service, is a welcome, but very limited, "extra bilateral" step toward meeting the need for expanded air service opportunities. We also welcome recent policy statements and initiatives by the Administration oriented toward a more liberal approach to international air services.

We also understand that it takes two, or more, parties to enter into agreements on air services. We cannot impose our perspectives on other governments. However, we can and should take every opportunity to place as much reliance on competitive market forces as can be made acceptable to our aviation partners.

That opportunity is directly before us: negotiations on a new air services agreement with Canada are about to begin. These negotiations affect our single largest, but also a relatively poorly served, international air transportation market. A liberal agreement with Canada has the potential of vastly expanding the size, quality and diversity of air services between the two countries, with the resulting economic and social benefits to citizens on both sides of the border.

U.S. airport operators sincerely hope that these negotiations will be successful, and will expeditiously bring an expansive liberalization of air services in the U.S. - Canada markets. On October 25th of last year, at AOCT's Annual Conference, U.S. airport operators endorsed a resolution (which is attached in its entirety) urging U.S. -

Canada air service negotiations with the goal of achieving an open skies agreement and the significant expansion of transborder air service. The resolution also accepts the proposition of cabotage rights for airlines of each country, if that is necessary for the successful conclusion of an agreement.

Each community in this country has a unique air service market demand requiring air service of different levels and types. The route and service structure codified in the patchwork quilt of bilateral agreements over the past half century simply does not provide the flexibility and dynamism required to meet the underlying international air traffic demand of communities.

Unprecedented expansion of the airport and airway infrastructure is now achievable, largely as a result of the landmark Passenger Facility Charge and FAA Reauthorization legislation enacted last year through your leadership, Mr. Chairman, and the dedication of the members of the Subcommittee. The regulatory regime must also foster a new period of liberalization and opportunity for communities, for air carriers, and for the travelling and shipping public.

Mr. Chairman, that concludes my prepared testimony. I would be pleased to address any questions you or other members of the Subcommittee may have.

RESOLUTION NO. 1

TOWARDS A NEW UNITED STATES-CANADA AIR SERVICES AGREEMENT
(U.S. Members Only)

WHEREAS, the United States-Canada air service market is the largest U.S.-international air travel market with 13.1 million passengers in 1989, out distancing the second largest market - Great Britain - by nearly 30 percent. Nevertheless, U.S.-Canada air travel increased in total by only 15 percent during the 1980's, while U.S.-Canada total trade grew by 49 percent and air travel for all other U.S. international markets surged by 63 percent. The current restrictive aviation agreement between the U.S. and Canada contrasts not only in principle with the recently concluded U.S.-Canada Free Trade Agreement (FTA), which significantly reduces or eliminates most barriers to transborder trade in goods and services, but through its obstacles to free circulation of passengers and freight, impedes the success of the FTA.

WHEREAS, the governments of the United States and Canada have deadlocked in their attempts to forge a new air transport agreement to replace the antiquated agreement last revised in 1974; negotiations between the two governments on a new agreement have continuously faltered, with the most recent attempt, in 1985, failing in part as a result of the United States' rejection of Canada's demands for limited cabotage rights. As noted, a new agreement is essential to replace the obsolete current agreement, which inhibits the free movement of travelers and cargo between U.S. and Canadian cities.

WHEREAS, contemporary realities of U.S.-Canada air service needs are not reflected by the current agreement as convenient service exists in only 30 percent of the 240 most significant transborder markets. Most markets are one-carrier monopolies as just 7 percent of the markets have two or more carriers competing; and U.S.-Canada scheduled capacity has increased very little since 1980, with non-stop seat capacity in the top 25 transborder markets increasing by only 21 percent.

WHEREAS, a new open skies aviation agreement would spawn broad benefits for U.S. communities and the U.S. economy as a whole by fostering U.S.-Canada trade, encouraging Canadian investment, conveniencing tourists, satisfying regional needs and promoting air carrier interests. Studies show that such new agreement would have produced at least \$4.1 billion (U.S.) more in economic benefits to airport communities in 1989 alone by increasing the number of scheduled air passengers to more than 15 million and substantially facilitating the flow of air cargo.

WHEREAS, the U.S. Secretary of Transportation and the Canadian Transport Minister announced on October 3, 1990 that both countries would resume bilateral air negotiations in early 1991 with the goal of achieving a new, open skies bilateral aviation agreement.

NOW THEREFORE BE IT RESOLVED, by the United States Members of the Airport Operators Council International that the United States government resume immediately bilateral aviation negotiations with the Canadian government with the goal of achieving, by June 1991, for implementation by April 1992, after any necessary congressional action, an open skies agreement with Canada enabling U.S. and Canadian carriers without restriction to fly between any U.S. and Canada pair of points or combination thereof, with the needed amount of flexibility in pricing and route rights so that airlines can significantly expand transborder service, and with cabotage rights for airlines of either country to carry local traffic in the other country's territory on extensions of transborder flights, if necessary for the successful conclusion of a new U.S.-Canada aviation agreement.

*Adopted at the General
Membership Business Meeting
of the Airport Operators Council International
on October 25, 1990*

TESTIMONY

of

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Before The
Subcommittee on Aviation of the
House Committee on Public Works and Transportation

March 21, 1991

TESTIMONY OF BRIAN MOREAU

Mr. Chairman, members of the Committee, my name is Brian Moreau. I am President of the Independent Union of Flight Attendants and I am here testifying on behalf of the 30,000 Flight Attendants at American, Pan Am and TWA. Thank you for the opportunity to testify before the Committee on the expected state of the airline industry over the next two years. I would like to respond to the Committee's questions with an ear toward the effects these events will have on the employees of U.S. carriers.

FINANCIAL

Over the next few years, the consolidation on the industry will continue. Eastern is gone. Pan Am, operating day-by-day under the protection of Chapter 11 bankruptcy protection is hanging on by a thread. Continental is also in bankruptcy. The Chairman of TWA has threatened the same for that carrier. Midway is under severe pressure.

In its struggle to survive, Eastern sold its Latin American routes to American. Pan Am is surviving today solely as a result of major asset sales. Along with its non-airline subsidiaries, it has sold its inter-German airline division to Lufthansa and its Pacific and Heathrow route authority to United. The Pan Am Shuttle is on the auction block, and we have reason to believe that it will be sold in the near future. Many analysts believe

Pan Am to be biding time until it can sell its Latin American division or its Frankfurt or New York operations. TWA wants to sell its Heathrow routes to American. Continental has sold its Seattle to Tokyo flights to American. It is reasonable to believe that these asset sales will stop only when there are only three or four airlines left.

It is the employees of these carriers who struggle in the wake of these corporate wheeling and dealings. Of the approximately 700 to 900 Flight Attendants required to fly Pan Am's Heathrow operation, only slightly more than 250 have been offered transfer with the routes to United. No United States-based TWA or Continental employees are being offered employment with American. No United States-based Eastern employees were transferred with the sale of their Latin American Division. Not so with foreign employees. American took all of Eastern's Latin American employees. United took all of Pan Am's foreign employees in the Pacific sale, and most in the Heathrow sale. In case after case, the foreign employees, protected by their governments, are offered jobs. U.S.-based employees are offered the streets.

This trend will continue. The acquiring carriers want new-hire entry level employees, not seasoned veterans. And why not. A new hire Flight Attendant at United, on the B-Scale, is paid \$1,039 dollars base pay per month. A 20 year Pan Am Flight Attendant is paid \$2,128. Multiply the difference by the 900 or so jobs at stake for Flight Attendants alone and you can see that

the acquiring carriers are financing their acquisitions off the backs of the very employees who have worked so diligently over the years to make the routes prosper.

Since the U.S. government is allowing Corporations to buy and sell public assets - the route authorities and gates and slots at public-financed airports - the Congress should mandate that it is the public policy of this government to ensure that jobs are transferred with assets.

One issue has been entirely consistent throughout all asset sales. The D.O.T. routinely dismisses Labor Protective Provisions, stating time and time again that protection over route sales must be bargained for. That means very little to the Pan Am employees who bargained for severance pay in the Pacific sale to United, who after a three-year arbitration, won their severance pay issues, only to find out that these payments will not now be made because of Pan Am's bankruptcy. It means little to the Flight Attendants in London who were not offered transfer to United, even though that right was bargained for.

Employees are caught in a "catch 22". The D.O.T. tells us, the unions, to bargain job protections with our carriers. We do. The carriers then sells routes or assets, without the bargained-for protections. The unions move to implement the protections, only to be told by the acquiring carrier that it had no legal obligation be bound by those bargained-for protections. And the

courts back that position. The only enforceable gain from these negotiations appears to be severance pay for displaced employees. And as stated earlier, a bankrupt carrier is likely not to pay that. Airline workers aren't looking for severance pay - we are looking for a job - for gainful employment.

The Congress should mandate that the Department of Transportation issue appropriate Labor Protective Provisions in every merger or acquisition.

The issue of Aviation Security is another area of discriminatory practice between U.S. employees and foreign nationals. The Aviation Security Act on which this Committee worked so diligently last session of Congress provides for criminal background security checks of U.S. aviation employees who have access to secured areas at U.S. airports. Every indication from the FAA shows that foreign national crew members will not be held to this same test even though they may have access to U.S. airport secured areas. It has been predicted that any attempts to hold foreign nationals to the same standard will run into similar problems as experienced with the drug testing of foreign nationals which has yet to become effective.

These problems stem from complicated bilateral agreements between foreign countries that must be negotiated. Some foreign countries will not legally allow employees to be subjected to such personal intrusions. U.S. air carriers are forced to bear

large financial costs to comply with the U.S. requirements for drug testing and background checks. In looking to the future and a global economy, U.S. employees and U.S. air carriers should be held to the same standards as foreign national crew members and foreign carriers.

FOREIGN INVESTMENT

On the financial front, another issue to be debated is increased foreign ownership in U.S. carriers. As a matter of principle, employees of U.S. carriers would oppose substantial foreign investment. We have enough trouble negotiating with managements in our own city, state or country. The difficulties of working for unseen and unknown entities "across the pond" can only be imagined. For example, had the Shah of Iran completed his purchase of 25 percent of Pan Am in the early 70s, the United States could have found itself in a very sticky situation when Iran was holding U.S. citizens as hostages.

But given all the inherent problems, airline employees would unerringly choose increased foreign ownership over the liquidation of their carrier and the loss of their jobs. We will leave it to others, including Congress, to decide if public policy allows for a foreign carrier to effectively buy cabotage rights through a significant investment in a U.S. carrier.

CABOTAGE

Quite possibly, cabotage will be the most widely debated issue of the next two years. Our concern on this issue was heightened only a few months ago when "Open Skies" talks with Canada were announced and now with the current free trade talks with Mexico the three independent flight attendant unions must stand opposed to all forms of cabotage. We all know that current Mexican labor costs are too low for us to compete with them. But just as important are the many problems associated with safety that will arise. Who will set the safety standards? Which agency will be responsible for oversight?

In an earlier hearing before this committee, the panel was asked if a form of reciprocal cabotage would be acceptable to U.S. flight crews - for example, U.S. crews working all flights of a Canadian carrier operating within Canada. And in the opposite, Canadian workers operating on U.S. carriers between Canadian points. While that concept cannot be dismissed out of hand, a deeper evaluation shows that it leaves some important issues unresolved.

First, the foreign carrier operating in the U.S. would hire entry level workers at new-hire pay rates. That, of course, would continue the pressure on incumbent U.S. carriers to lower their wage rates to match those lower levels. The effects may be subtle, but they will be real.

Secondly, how does such a reciprocity work for incumbent U.S. carriers with an established work force? Pan Am and TWA have a substantial foreign presence. Will our current flight crews be displaced because a foreign government insists that its nationals operate on certain foreign sectors? We fear that any protection offered by the "reciprocity" provisions will be only paper protections. We ask this Congress to "just say NO to cabotage".

And if the airline industry is becoming global, then U.S. labor must also be allowed to globalize. I would like to bring to the attention of the committee a new issue that must be addressed. A recent United States Court of Appeals decision effectively removed the right of U.S. labor unions to negotiate enforceable contract provisions for foreign point to foreign point flying. The court ruled that disputes arising from agreements made under the provisions of the Railway Labor Act could not be arbitrated if the dispute involved totally foreign flying. It stated, in part, that the Congress never intended for the Railway Labor Act to apply to such flying.

For a workforce like Pan Am's or TWA's which have performed extensive foreign flying, to be told after 60 years by the courts that our negotiated contracts are unenforceable is startling. And contract provisions negotiated by the "new kids on the block" - American and United - are only as good as the intentions of the carriers. Parts of agreements cannot be arbitrated or

enforced.

This is especially distressing in that many carriers are now employing "foreign national" Flight Attendants. Each Union has negotiated with its carriers to limit the number of foreign nationals. If this court decision stands, some of those protections may be gutted.

We ask the Congress to quickly pass legislation that re-establishes the rights of labor unions to make agreements and resolve disputes under the Railway Labor Act. Not just agreements that apply within the U.S. or on sectors that originate or end in a U.S. city, but world-wide, enforceable agreements.

Our unions understand that the world is changing. Most assuredly, we will adamantly oppose some of these changes that can substantially harm the people we represent. But change will come - for good or bad. Labor must be allowed to change with the times. We must no longer be prohibited from competing in the world market place.

If there is to be a new level of global competition, give labor the right to compete as well. Let there be competition of ideas. Give U.S. labor unions the right to fully represent our members in flying overseas and to reach out and organize the foreign workers that crew our aircraft.

Today, the laws of our country effectively prevent such representation. We ask Congress to level the playing field. Amend the Railway Labor Act to explicitly bring foreign point to foreign point flying within the coverage of the Railway Labor Act and to allow for foreign crewmembers working for U.S. carriers, with their consent and the consent of their governments, to be represented by U.S. labor unions.

Once again, I appreciate the opportunity to testify here today.
Thank you.

TESTIMONY BEFORE
THE SUBCOMMITTEE ON AVIATION OF THE
HOUSE COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
OF
ALASKA AIRLINES, INC.
MARCH 21, 1991

Alaska Airlines' Chief Executive Officer, Mr. Raymond J. Vecchi, appeared before the Subcommittee on February 5 and addressed several Department of Transportation regulatory policies which Alaska believes have unduly hampered the few remaining smaller carriers' ability to compete as effectively as they otherwise could. Although the Department has publicly stated that it sees no loss of public benefits resulting from a reduction in the number of major carriers to only 3-5, Alaska strongly disagrees. The smaller major and national carriers have served as significant competitive forces in both the domestic and international arenas. Wholly apart from Alaska's and Horizon's more than 7,500 employees, shareholders and lenders, Alaska's loyal and growing passenger base consistently shows Alaska to be one of those carriers with the most favorable consumer complaint record. That is the best indication of Alaska's value as a competitive force.

While some seem determined through creeping changes in foreign ownership, cabotage and bilateral negotiations to make the British Airways and Japan Air Lines of the world the only real domestic as well as international competitors for American and United, Alaska has a better solution. The solution is for legislation requiring the Department to change those policies which, whether intended or not, have created a significant tilt in favor of the mega-carriers. That is a far better answer than granting British Airways and Japan Air Lines de facto entry to the domestic markets because of the continued erosion of the competitive posture of the smaller major and national carriers.

Legislation is the only answer. Surely the absence of American and United from each of the recent hearings is a strong indication that, without legislation, those carriers perceive that nothing is likely to change at the Department to even partially correct the playing field which is heavily tilted in their favor.

The two subjects on which Mr. Vecchi focussed were:

- (1) the Department's unwillingness to impose any restraints on the high level of computer reservation system booking fees which have forced the smaller carriers every year to transfer many millions of dollars to the mega-carriers; and

- (2) the Departments' recent relaxation of its restrictions against foreign ownership and control which is likely to have the perverse effect of further strengthening the mega-carriers.

Nothing has changed in the past six weeks to alleviate these concerns and, indeed, the recent amendment to the U.S.-U.K. aviation bilateral agreement represents yet another instance in which the Department's actions have once again worked to provide benefits to the mega-carriers at the expense of the smaller carriers.

Alaska is also concerned, in the context of the just-started U.S.-Canada bilateral negotiations, that the Department may afford the U.S.-Canadian route expansion plans of the mega-carriers greater priority over the expansion plans of the smaller major and national carriers. The decisions concerning which new U.S. carrier routes will receive priority in terms of the date service is to be inaugurated can and will have a significant impact on the smaller U.S. carriers. Very much related to the question of which routes receive that priority from the Department is the Department's carrier selection policy which will come into play in those route proceedings involving competitive carrier applications.

The route expansion desires of the smaller major and national carriers should not be relegated to lower priorities just because a particular route may not involve service from an

established fortress hub such as Denver, Washington or Atlanta. The Department's carrier selection criteria should be revised to place greater emphasis on the long-term structural benefit of providing the smaller major and national carriers with access to lucrative international routes. Without such access, the smaller carriers, even those with the financial strength of Alaska Airlines, are facing the continued erosion of their ability to compete effectively.

It is time to lessen the heavy tilt in that so-called "level playing field" to allow the small major and national carriers a fair opportunity to remain effective competitors. This is a far better solution than turning our markets over to the larger foreign carriers.

The Recent U.S.-U.K. Agreement

The recent U.S.-U.K. Agreement was negotiated to gain access to London's Heathrow Airport for American and United, while at the same time, in the case of Pan American, assuring that that carrier received needed revenues for the sale of its principal transatlantic routes. Alaska is also aware that the U.K. has always proved to be a tough negotiator. But what happened to the United States?

In addition to giving the British the right to designate additional U.K. carriers, the right to serve additional U.S. gateways for transatlantic service, virtually unlimited code-

sharing rights throughout the United States and unique cross-investment privileges vis-a-vis other European carriers, the United States also gave the British extremely valuable fifth freedom authority in the U.S.-Latin American, U.S.-Pacific, U.S.-Canadian and U.S.-Mexico City markets.

Alaska's concern is with the latter two groups of markets. For the first time, as many as three U.K. carriers will have the right to serve Mexico City from every major West Coast city, particularly including Los Angeles. Yet Alaska has been trying to gain entry as a third U.S. carrier to the Los Angeles-Mexico City market for more than a year. Our efforts have not succeeded and now we find that the U.S. has just given away three times these same Los Angeles-Mexico City rights which Alaska still does not have.

In an almost identical vein, the United States also gave three United Kingdom carriers the right to serve every significant West Coast-Canadian market. It just so happens that the United States is about to embark on what most expect will be a rather protracted series of negotiations with the Canadians in an effort to significantly expand the restrictive U.S.-Canadian aviation bilateral agreement. The Secretary has said that he expects that such negotiations may take as much as two years. Alaska welcomes these negotiations because the Canadian, as well as the Mexican, markets are natural expansion areas for Alaska. But giving three United Kingdom carriers the right to serve every

valuable West Coast-Canadian market is certainly going to complicate matters. What additional price will the Canadians now demand from the U.S. in order to permit more U.S. carriers to serve these markets?

The Department should not have structured the U.S.-U.K. settlement to permit the United Kingdom entry into markets where U.S. carriers have unsuccessfully sought entry. Every U.S. carrier deserves better treatment and when the result falls disproportionately on one of the few remaining small carriers, as in this case, Alaska believes that the Department must now take prompt corrective action to remedy the situation. Surely, Alaska's shareholders, directors, officers and employees who have labored to maintain a record of profitability for 18 consecutive years are no less deserving than those of Pan American, American or United.

Access to Limited Entry International Routes Is Essential
To the Long-Term Competitive Success of the Smaller Carriers

It is well known that limited entry international routes are desired because the profit potential on such routes often exceeds that generated by the typical domestic market. The reasons for the higher level of profitability relate to the enhanced ability to generate long-haul traffic which will also flow across the carrier's domestic system, the generally longer hauls involved and the often lesser degree of competition which usually translates into higher fares. Certainly the frenzy that

accompanies the announcement that additional Tokyo routes will be available can be directly related to the far higher profit potential of those routes.

What we now see, however, is that most of the more lucrative, limited entry international routes have fallen into the hands of either American or United. Pan American's and TWA's transatlantic presence is a rapidly fading memory. United swallowed Pan American's entire transpacific system in one fell swoop. American acquired Eastern's extensive Latin American system less than a year ago. It has also been reported that United is anxious to buy Pan American's Latin American route system as soon as Pan American's financial circumstances place that carrier in the position of once again having to sell its ever diminishing assets.

American and United, with only limited exceptions, have become the dominant international U.S. carriers as a result of route transfers all of which have been approved by the Department in the last five and one-half years. The combination of American's and United's omnipresent domestic route systems, exorbitant CRS booking fees and control of gates at many congested airports have generated enormous cash flows for those carriers. Those deep pockets in conjunction with the Department's blessing has resulted in the extension in just five years of American's and United's domestic dominance to the international markets.

So far as Alaska is aware, the Department has never in the context of even one of these route transfer proceedings examined the long-range structural implications of placing so much valuable international route authority in the hands of the two largest U.S. carriers. Deep pockets and the Department's route transfer policy have combined to produce far greater industry concentration than has ever occurred before in so short a period of time. In that same brief time span, the ability of the smaller major and national U.S. carriers to compete effectively has axiomatically been made that much more difficult.

**The Department's Carrier Selection Policy
Has a Decided Large Carrier Tilt**

The Department's carrier selection policy used to decide which carrier receives new authority in limited entry international markets is another policy which is heavily tilted in favor of the mega-carriers. That is also the policy which, for example, will determine, in the instance of competing carrier applications, which carrier will get to serve new U.S.-Canadian markets.

That policy should be revised to reverse the trend that has resulted in most of the real plums in recent international route proceedings going to the larger carriers. The Department's carrier selection criteria should be revised to eliminate the inherent bias favoring the larger carriers. Much of that bias derives from the significant decisional weight which the

Department accords the number of beyond-areas U.S. cities which can be served with new single-plane and on-line connecting service between a U.S. gateway city and a foreign point. In other words, the Department's carrier selection decision often boils down to which U.S. carrier can serve the greater number of interior U.S. cities. Obviously, that criterion heavily favors the mega-carriers with their vast domestic route networks.

Rather than perpetuating a system heavily skewed in favor of the mega-carriers, the Subcommittee should enact legislation mandating that the Department revise its carrier selection criteria to establish a presumption of significant competitive benefits to be derived from the selection of a smaller carrier presenting a credible proposal when the proposed new route would represent a significant portion of that carrier's system. Without such a criterion to at least partially offset the heavy decisional weight the Department has typically afforded to so-called beyond-benefits, the Department's carrier selection proceedings will continually leave the smaller carriers behind. The size differential between the smaller carriers and the mega-carriers is increasing and so therefore is the degree of bias under the present policy. The Subcommittee should not allow the Department's carrier selection policy, along with the Department's route transfer policy and continued inaction on CRS booking fees, to continue as yet another major obstacle for the smaller major and national carriers to have to overcome.

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The Department's Continued Inaction With Respect to
Computer Reservation System Booking Fees

Since Alaska testified six weeks ago with respect to the Department's continued inaction in even issuing a Notice of Proposed Rulemaking with respect to the Department's CRS Rule, there have been increasing rumors that the Department will finally issue its long awaited Notice of Proposed Rulemaking. Unfortunately, those rumors also indicate that the proposed revisions will once again fail to address the overarching problem of CRS booking fees. If indeed that turns out to be the case, the only avenue left to the smaller carriers will be for legislation mandating that the Department amend its CRS Rule to provide for outside arbitration in those instances where it appears that a CRS vendor-carrier's booking fees are excessive in relation to that carrier's cost of providing that service. It is nonsensical for the smaller carriers to continue to have to subsidize the mega-carriers so that these carriers can purchase massive route networks.

Conclusion

Alaska has concluded that corrective legislation is likely to be the only effective means of correcting the heavily skewed playing field the smaller major and national carriers are facing. The combination of inaction by the Department during the prior Administration with the flurry of decisions by the current Department has greatly added to the market power, internationally

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as well as domestically, of the already dominant mega-carriers. The size disparity between the mega-carriers and the other smaller carriers is increasing rather than narrowing. The threat of any real new entrants to provide a meaningful level of competition is gone. The remaining choice to reinvigorate the competitive market is between the smaller major and national carriers, on the one hand, and British Airways and Japan Air Lines, on the other. The correct choice is easy and it is the one which the Subcommittee should adopt.

ADDITION TO THE RECORD

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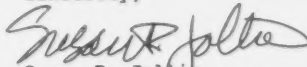
The Honorable James L. Oberstar
Chairman
Aviation Subcommittee
Committee on Public Works and Transportation
2251 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Oberstar:

On behalf of our client American Trans Air, we ask that you enclose a copy of the attached statement in the hearing record. This statement responds to testimony offered at the Subcommittee hearings on March 21, 1991, which ATA fears may have improperly characterized a proceeding pending before the Department of Transportation.

Thank you for your consideration of this matter.

Sincerely,


Susan B. Jollie
Attorney for
American Trans Air, Inc.

Enclosure

STATEMENT OF
AMERICAN TRANS AIR, INC.

American Trans Air strongly supports the Aviation Subcommittee hearings on international aviation policy, including an evaluation of the Department of Transportation's policies concerning airline competition. We share your view that the Airline Deregulation Act places an affirmative obligation on DOT to make carrier selection decisions that do not preclude access by new competitors to valuable limited entry routes. American Trans Air desires to become a more competitive force, on a limited basis and in niche markets, yet we are frustrated to some extent by policies of the Department of Transportation, which appear to favor the large mega-carriers.

While American Trans Air fully believes DOT should give high priority to satisfying the aspirations of new entrant airlines, we would like to correct any misimpressions which may have resulted from testimony of Baltia Air Lines before this Subcommittee on March 21, 1991.

Baltia based its complaint concerning DOT's treatment of newly-formed carriers on the recommended decision of the administrative law judge in the U.S.-U.S.S.R. North Atlantic Combination Service Case. It is correct that Baltia, a newly-formed, paper carrier, was not recommended for an award of

authority to the U.S.S.R., but the basis of that decision did not relate to Baltia's status as a "new entrant."

The law judge recommended the award of non-Moscow authority to American Trans Air, which is also a new entrant, because he found our service proposal "superior" and because we demonstrated that we have the "management skills, experience, financial, and other resources to operate an efficient airline." American Trans Air is a profitable and successful U.S. carrier, operating a fleet of 21 aircraft (7 B-727s; 10 L-1011s; and 4 B-757s, with two additional B-757s to be delivered in the first quarter of 1992). During the DOT hearing, Baltia was accorded multiple opportunities to revise its unworkable and unrealistic service proposal into something practical and appropriate to the needs of the market, but it could not.

American Trans Air does not believe the Department must fulfill its responsibilities to promote new entry by disregarding traditional carrier selection criteria. Indeed, DOT would be remiss in its duty if it did not require new entrants to demonstrate the economic viability of their service proposals, quality of service, and overall management and organization competence.

ATA is concerned, however, with decisions that improperly emphasize carriers' hub dominance or competitive strength based on a dominant industry market share. Use of these non-traditional carrier selection criteria will assure that a well-qualified carrier such as ATA will never get a chance to operate scheduled international services. We believe that Congress intended to create reasonable opportunities for new entrants. ATA has so far been a deregulation success story, and, with your assistance, we will continue to prosper.



REVIEW OF U.S. INTERNATIONAL AVIATION POLICY AND BILATERAL AGREEMENTS

THURSDAY, MAY 9, 1991

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON AVIATION,
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION,
Washington, DC.

The subcommittee met, pursuant to recess, at 11:05 a.m. in room 2253, Rayburn House Office Building, Hon. James L. Oberstar (chairman of the subcommittee) presiding.

Mr. OBERSTAR. Before we begin today's hearing, I would like to insert into the record the summary of activities subject matter for today's hearing.

[Summary referred to follows:]

Committee on Public Works and Transportation

Congress of the United States

House of Representatives

Room 2105, Rayburn House Office Building

Washington, DC 20515

TELEPHONE AREA CODE 202, 225-4472

May 7, 1991

To: Members of the Subcommittee on Aviation

From: Committee Aviation Staff

Re: SUMMARY OF SUBJECT MATTER for hearing on the REVIEW OF U.S. INTERNATIONAL AVIATION POLICY AND BILATERAL AGREEMENTS Thursday, May 9, 1991.

This hearing is a continuation of hearings held on March 19 and 21. The Summary of Subject Matter from the prior hearings is attached. This Summary describes significant developments since the March hearings.

Recent Legislation Affecting U.S. International Aviation Policy

On April 24, the Committee leadership introduced H.R. 2074, the Airline Competition Enhancement Act of 1991. Hearings on this bill (as well as H.R. 66 introduced by Congressman Boehlert, H.R. 782 introduced by Congressman Clinger and H.R. 2037 introduced by Congressman Hammerschmidt) are scheduled for Wednesday, May 15 and Wednesday, May 22.

Among the policy initiatives embodied in H.R. 2037 and H.R. 2074, are changes in the regulation of international route transfers and foreign ownership and investment in U.S. carriers. As these are significant components of U.S. international aviation policy, these bills may be discussed in the May 9 hearing by Members and witnesses.

Section 2 of H.R. 2074 establishes new procedures for the transfer of routes or certificates to engage in foreign air-transportation. (Under the bill, the same procedures would apply to the transfer of large blocks of gates and slots.) The bill directs the Secretary of Transportation to establish procedures to ensure that before the routes are transferred, all persons interested in purchasing the routes have an opportunity to submit proposals specifying the purchase price they

would pay and their plans for the routes. From among the proposals offering a reasonable price for transfer of an international route, the Secretary shall select the one which would provide the maximum enhancement of the public interest. The factors to be considered in determining public interest are: the factors listed in Section 102 of the Federal Aviation Act (related to safety, competition, and development and promotion of civil aeronautics), the enhancement of the financial viability of each of the carriers included in the transaction, the enhancement of competition among air carriers, the enhancement of the trade position of the United States in the international air transportation market, and a commitment by the transferring carrier to use the funds received to provide air transportation. The Secretary may determine that none of the eligible proposals would further the public interest.

Section 3 of H.R. 2074 amends existing law by establishing a new general rule that U.S. citizens must own at least 75% of the equity (whether voting or non-voting) of a U.S. air carrier. The Section also continues the requirement in existing law that U.S. citizens must own 75% of the voting stock of a U.S. air carrier. The Section allows the Secretary of Transportation to reduce the requirement of 75% stock ownership by U.S. citizens (by vote or value) to 51%, in cases in which the Secretary can make the following findings:

- o the air service agreement between the United States and the foreign country of which the purchaser is a citizen is a "pro-competitive" agreement, meeting specified requirements;
- o after the purchase, the President, Chairman of the Board, Chief Operating Officer, and two-thirds of the Board of Directors of the air carrier will be citizens of the United States;
- o the laws and regulations of the foreign country involved permit a citizen of the United States to acquire the same percentage of stock in a foreign air carrier;

- o the purchaser is not a corporation which is more than 50% owned or controlled by the government of a foreign country;
- o the air carrier is unlikely to be able to provide air transportation without the revenues which would be derived from the sale of the stock and no citizen of the United States is willing to purchase the stock under comparable terms and conditions;
- o after the purchase of stock by foreign citizens, a citizen of the United States will continue to have the power to exercise control over the air carrier;
- o the purchase is consistent with the national security interests of the United States; and
- o the purchase is otherwise in the public interest.

Congressman Hammerschmidt's bill, H.R. 2037 (introduced on April 24), also contains provisions that would significantly change policy on the transfer of international routes. H.R. 2037 would establish a public interest test for DOT to use in evaluating proposed international route sales. This would include an evaluation of the impact of the route sale on the viability of the carriers involved and on domestic competition generally. The bill would also direct DOT to consider competing applications for a route. In choosing among competing applications, some of the factors that DOT would be required to consider would be the quality of passenger service provided by each of the competing carriers, competition enhancement among carriers, and the financial viability of the buying and selling carrier. The bill would also require, in appropriate cases, the submission to DOT of a financial plan by the selling carrier to insure that the proceeds of a route transfer are used to maintain the carrier's financial viability. DOT may require the selling carrier to agree to implement the plan.

Also, on March 22, the Committee leadership introduced H. Con. Res. 111 urging the President and the United States Trade Representative not to propose or support the inclusion of civil air

transport services under the General Agreement on Trade in Services that is being negotiated under the auspices of the General Agreement on Tariffs and Trade. This Resolution is identical to H. Con. Res. 280 which garnered 178 cosponsors in the 101st Congress.

D.O.T. Approval of American/TWA Route Transfer

On April 25, DOT approved the transfer of three TWA London routes (New York, Los Angeles, and Boston) to American Airlines. At the same time, the Department disapproved the transfer of three smaller routes to London which had been proposed for transfer (Baltimore, Philadelphia, and St. Louis). The decision was extraordinarily controversial in that numerous Members of Congress, including the leadership of the Committee, had opposed the transfer of the routes, believing the transfer was likely to be the beginning of a wholesale liquidation of TWA's valuable international routes and other assets and the demise of the carrier.

On May 2, American agreed to pay TWA the originally negotiated price of \$445 million, even though three of the routes in the original deal will not be transferred. American plans to start operating the routes on July 1. Some uncertainty over the transaction remains since Missouri civic leaders and TWA's unions are expected to file for judicial review of the DOT decision approving the route transfer.

Improvement of International Airline Traffic

Beginning late last year and continuing through the early part of this year, recession, fears of terrorism and war between the Allies and Iraq caused dramatic and record declines in international airline traffic (in some cases as much as 35% compared to the previous year). It appears that with a cease fire now in place in Iraq and the fear of terrorism subsiding, international air traffic is rebounding slowly. Despite record drop offs in the first three months, 1991 U.S. international traffic is expected to be up approximately 3% over 1990. Stronger international travel would certainly improve the financial picture of carriers with significant international route authority.

Civil Aviation Negotiations

Early in April, U.S. and Canadian aviation negotiators met in Ottawa to initiate talks aimed at establishing an "open skies" aviation regime in which U.S. and Canadian air carriers could operate between any cities of the two countries (and possibly within each other's countries) with a minimum of government approvals or regulation. Further talks are scheduled for early June in Washington and are not expected to conclude for at least a year.

Also last week, negotiators from the U.S. and the United Kingdom met to discuss the framework for future negotiations to liberalize the conservative aviation regime between the two countries. When an agreement was reached in March to permit United and American to succeed Pan American and TWA, the two countries agreed to discuss a future "open skies" arrangement between the two countries. The U.K. is very interested in seeing a relaxation of the United States' foreign investment standards. The talks will resume late this summer.

While no agreements were reached in these discussions, none were expected, as these talks were preliminary to future rounds of discussions and consisted of exchanges of studies and philosophical approaches to the issues.

Anticipated Witnesses

- * Dr. Alfred E. Kahn; Julius Thorne Professor of Political Economy Emeritus; Cornell University.
- * Dr. Michael E. Levine; Dean, Yale School of Organization and Management.
- * Mr. David H. Treitel; Executive Vice President; SH&E, Inc.
- * Ms. Judith Trent; Managing Director; Global Aviation Associates, Ltd.
- * Mr. J. George Mikelsons; President; American Trans Air.
- * Mr. John J. Maloney; President; Florida West Airlines.

Mr. OBERSTAR. The Subcommittee on Aviation will please come to order.

This morning we meet to continue our inquiry into and review of U.S. international aviation policy. We'll have additional hearings on the general subject, as well as the specific legislative proposal that Congressmen Roe, Hammerschmidt, Clinger, and I have introduced to reflect the findings and conclusions we have drawn from our earlier hearings and from reflections thereupon.

We will, of course, invite comments and pose questions to today's witnesses about the specific provisions of that bill. Some of the witnesses have, indeed, already made references in their testimony to the pending legislation.

Obviously, the continued competitiveness of U.S. carriers is a matter of very great concern and interest to all of us in the aviation community, especially to those involved in policy making. Aviation is one of the most significant economic sectors in the entire U.S. economy. It represents some \$600 billion of economic activity.

The center or the core of that activity is the U.S. airlines, the air carrier sector. Maintaining the thrust, the economic rush given to the airline industry by deregulation in the 1978, must continue to be the focal point of our policy objectives and policy actions.

Many questions have been raised about the viability of competition in the deregulated environment. There have been many questions by the traveling public, by the news media, and, indeed, for us members of Congress, by our own colleagues in both the House and Senate. How many carriers will survive? Will it be necessary to re-regulate? All too frequently, the questions from the news media, which reflect the growing public concern, are when will Congress—not whether—when will Congress re-regulate? Is it just around the corner?

My answer to that is, no. We will not re-regulate in the sense of pre-1978 regulation. We will not return to a regime of Government control of rates and market entry. We must refine the existing laws. We must open the doors wider to competition. We must engage upon an aggressive course of what I might call not a balance of equities, but a balance of opportunities—a balance of reciprocity that allows U.S. carriers to create at home and abroad the widest possible growth potential for themselves and for the traveling public. Given that opportunity, U.S. carriers, I'm confident, without shackles upon them by foreign competition, will out-compete the rest of the world's airline fleets.

Creating that and I should say nurturing that kind of pro-competitive environment is the quest of this subcommittee on a bipartisan basis. I want to express my appreciation for the strong support and cooperation and creative input from my colleague on this committee, Mr. Clinger, who has devoted so much time and effort to all of these issues and, of course, especially to our very, very able and imaginative staff.

At this point, the Chair would like to announce and to welcome to the committee hearing a very distinguished group of visitors from the Air War College. They represent 33 different countries. If I knew which ones, I could probably speak in some of your languages and give you a welcome. For the moment, we'll have to suf-

fice in English, and to also observe that most are pilots and, therefore, should have some interest in the subject pending before our committee.

Mr. Clinger.

Mr. CLINGER. Mr. Chairman, today's hearing, as you've noted marks the third in a series which we've had in this committee to discuss and consider international competition issues. Even though it has only been two months since our previous hearing on this subject, a number of very interesting developments have occurred in the international arena, which I think bear our scrutiny. The TWA-American route transfer case was decided. A new round of bilaterals have been initiated with the Canadian Government.

International routes, as you have indicated, have really become critical to the prosperity of our domestic carriers. I think many industry experts that I have talked with and that we've heard before this committee would agree that domestic markets, with some exceptions, have been fairly well saturated and have been fairly well exploited to the maximum. Intense competition among the relatively few remaining carriers makes it difficult for them to earn a reasonable profit on those domestic routes.

Fares charged on international routes, on the other hand, are still regulated, and offer carriers. A much greater opportunity for profit if they are able to develop and market those routes successfully. So we see tremendous competition for those passengers.

Consequently, I see the challenge faced by our domestic carriers occurring in two very distinct ways. At home, they've got to do everything possible to preserve market share so that they are able to feed the international routes which are the potential growths for the future. Abroad, the carriers have got to be able to compete with ever larger and more powerful foreign competitors if they are going to be able to generate a reasonable rate of return. So they are inextricably linked. Failing in either of these two arenas, I think, will seriously undermine the carriers ability to compete in the other. So we can not look at one without looking at the other. They are joined.

More than at any time following deregulation a decade ago, I have serious misgivings about the present course of the industry. Consolidation of routes, gates, and slots at home helps carriers develop a network to feed the international routes and compete against foreign carriers. Doing so, however, may have the result of reducing competition at home, particularly at the fortress hubs.

Yet, the antithesis is just as unsettling. That is, fostering a large number of domestic carriers may not allow any one company to generate enough corporate resources to compete against large, well-disbursed international players. So, we really have a very delicate situation to address. With these thoughts in mind, I look forward to hearing from our various distinguished panels of witnesses today. I want to thank them for taking time from what I know are busy schedules to appear before our committee.

Mr. OBERSTAR. Thank you very much, Mr. Clinger. Do any of the others have opening thoughts or observations?

[No response.]

Mr. OBERSTAR. I would like to enter into the record at this point a statement received from our colleague from Illinois, Mr. Jerry Costello.

[Mr. Costello's prepared statement follows:]

STATEMENT OF HON. JERRY COSTELLO, ILLINOIS

Mr. Chairman, today we continue our in-depth look at international aviation policy. There have been several new developments in this area since this Subcommittee last held hearings on the subject.

Today will be our first opportunity to examine, in a hearing setting, some of the provisions of H.R. 2074, the Airline Competition Enhancement Act. This bipartisan legislation, introduced by the Committee leadership, attempts to address some of the problems we have identified in maintaining airline competition in a post-deregulation industry. Of particular interest today will be provisions governing foreign investment in U.S. carriers, and directives to the Secretary regarding the transfer of international routes. I look forward to hearing the reaction of small carriers to these latter provisions, since many have felt that they are not well served by the current system for transferring routes.

Along with many of my colleagues, I was very disappointed that Secretary Skinner decided to allow the sale of three of

TWA's London routes to American Airlines. While the damage to TWA in this case may be done, it is my hope that we can work proactively to ensure that future route transfers are in the interest of the general public and of the carriers involved.

Mr. Chairman, I thank you for your continued leadership on this issue and I look forward to hearing from our witnesses.

Mr. OBERSTAR. We will then invite our first panel, consisting of Dr. Alfred E. Kahn, Julius Thorne Professor of Political Economy Emeritus at Cornell University, and Dr. Michael E. Levine, Dean, School of Organization and Management at Yale University. Dr. Kahn is formerly the Chairman of the Civil Aeronautics Board, 1977 to 1978. More importantly, he is known as the father of deregulation. We come here to perhaps make an assessment of the work product of your brain child, if you will, and that of your then-associate at the CAB, the Director General, then, Dr. Levine.

Together, I would say that we have the combined cumulative knowledge, wisdom, expertise, and inventiveness—father and god-father, if you will—of deregulation. [Laughter.]

Rarely have we had so distinguished a team in front of this committee and rarely has their combined institutional wisdom and experiential understanding been so important to aviation and to this committee.

Dr. Kahn?

TESTIMONY OF ALFRED E. KAHN, JULIUS THORNE PROFESSOR OF POLITICAL ECONOMY EMERITUS, CORNELL UNIVERSITY; AND MICHAEL E. LEVINE, DEAN, SCHOOL OF ORGANIZATION AND MANAGEMENT, YALE UNIVERSITY

Mr. KAHN. Thank you, Mr. Chairman.

I want to have an agreement in advance that if Dean Levine will not ask for a paternity test, then neither will I. [Laughter.]

I testified before this committee on the subject of international aviation policy almost fourteen years ago when I was Chairman of the CAB. Those hearings, you will recall, eventuated in the International Aviation Policy Act of 1979, which in effect endorsed the liberalization of the international aviation policy that the Carter Administration had been promoting.

We, at the Board, and I know this committee, felt that the evolving international policy that we were developing at that time was the logical compliment of what we were doing and trying to do domestically; that is, to remove the comprehensive regulatory restraints on competition that had evolved over the preceding 40 years. What we proposed was to trade liberalizations for liberalizations; that is, to offer foreign governments and airlines ampler opportunities to compete for international traffic between their countries and ours in exchange for equivalent opportunities for American carriers.

For example, we had impending negotiations with Japan at that time. I pointed out to the committee that we might find it to our advantage to offer the Japanese access to new U.S. points—not to give it to them in a niggardly spirit, but to say, come on in; we are prepared to offer you an opportunity to give additional service, additional competition to serve American markets, in return for a removal of competitive restrictions on U.S. carriers.

That is the kind of bargaining that is good for U.S. consumers. They benefit from the concessions we give, and they benefit from the concessions we receive.

Now, as you are well aware, we haven't, since that time, come completely, or even remotely close, to reproducing in the interna-

tional arena the through-going deregulation that we achieved domestically. Still, partly because of what we did at that time—we and this committee—international aviation today is much more competitive than it was 15 years ago, and the trend continues.

Incidentally, I am trying to summarize my statement. I assume that the entire statement will be included.

Mr. OBERSTAR. The entire statement will be included in the record.

Mr. KAHN. Thank you, Mr. Chairman.

I assume that the committee is not interested in yet another go around on the question of whether our deregulation of the domestic industry was or was not successful. I am happy to accept Secretary Skinner's declaration that that debate is over and, of course, I'm happy with his conclusion that deregulation has been a great success.

But it is relevant to the subject of these hearings that very few, even among the critics of deregulation, propose that we reimpose the comprehensive restrictions on competition that regulation entailed. I know that that's not the intention of this committee and I'm encouraged by your statement on that subject, Mr. Chairman.

Of course, I must except from this generalization such stubborn critics as Hobart Rowen of the "Washington Post". I will not impose on this committee by taking your time in my oral presentation, a refutation of my reputations over the years, and by the way, also by Dean Levine, of his muddle-headed and self-contradictory criticisms of deregulation. [Laughter.]

Mr. OBERSTAR. I said it to him, and there is no reason why I can't say it to you. [Laughter.]

Mr. KAHN. Other than the fact that it is muddle-headed and self-contradictory, it's very lucid. [Laughter.]

The fact remains that our domestic industry, as you pointed out, has become substantially more concentrated at the national level than it was before deregulation, that the trend continues, and that few of even the most ardent defenders of deregulation regard with complacency the possibility that the industry may shake down in the very few next years to only perhaps four major carriers, along with their satellite feeders and affiliates. Also, while we see an industry that is undeniably more competitive than it was permitted to be under regulation, we also see very sharp increases in the unrestricted fares paid by the very small minority of non-discretionary travellers, and particularly the ones that begin and end their journeys at hubs dominated by a single carrier.

There are three possible ways in which the Government might respond to this equivocal situation.

Number one, it could do nothing. We put up with a great deal of competitive imperfection in industries that we wouldn't think of regulating. The airline industry is far more competitive than it was; the benefits of that competition have been very widely distributed. Industry profits, as you point out, Representative Clinger, have been lower, on average, since deregulation than before. It certainly is not earning monopoly profits. In these circumstances, it would not be ridiculous to say that no remedy was required.

Second, and at the other extreme, it is not possible in principle to reject reimposing price ceilings to protect travelers who are sub-

ject to monopolistic exploitation, where restoration of more effective competition is not feasible. In my written submission, I summarize my reasons for being unwilling to recommend the reimposition of ceilings. But, since that issue is not before the committee, I won't spend my time in this oral summary giving those various reasons.

Finally, to come to the point of view that I gather the committee itself has, the Government clearly has neglected responsibilities of which it was never the intention of deregulation to relieve it. These include not only vigorous enforcement of the antitrust laws, but other policies designed to remove barriers to competition, such as are embodied in the bill that Chairman Oberstar has, in fact, introduced.

The reconcentration of the American industry could conceivably have been prevented, or at least moderated by more aggressive application of the antitrust laws, along with other competition-encouraging policies such as I have already alluded to and that I mention in my written statement.

We'll never know whether Piedmont, a Republic, or a Western might have survived as effective competitors, had the Department of Transportation not continued to assume that airline markets were perfectly contestable, despite mounting evidence to the contrary, when they were confronted with the disappearances of these companies through mergers.

In any event, it seems to me the opportunity to test that hypothesis has passed. While I intend in no way to minimize the importance of intensified Government efforts to preserve or encourage competition, such as are included in your bill, we must confront the strong possibility that the principal source of competitive protection for consumers henceforward, so far as the U.S. airline industry is going to provide it, will have to be competition among a handful of mega-carriers.

This means, I feel strongly, that while proceeding much more vigorously than before to attack barriers to genuinely new competitive entry into domestic markets by U.S. carriers, we must now, before it is too late, seek protection also in the proposition that eight or ten mega-carriers, operating worldwide, will almost certainly give travelers sufficient protection, provided they all have unrestricted access to the markets that we're worried about. American consumers should not have slept well in the 1970s when they were served preponderantly by only three major U.S. automobile companies; but today, eight or ten mega-automobile manufacturers, operating worldwide, give us ample competitive protection.

The same principle applies to aviation.

Of course, I am aware of the political and the legal obstacles to genuinely free trade in aviation services; but the opportunities are surely there, and when and if we become sufficiently concerned about concentration of our domestic industry, we must take advantage of them. The domestic U.S. travel market from which foreign carriers are, of course, excluded, is a very tempting target for them. To the extent we could trade access to it for corresponding opportunities for our carriers abroad, the benefits to American carriers and their employees might well be sufficient to compensate

for the increased competition to which they would be subjected. Of course, there would be undiluted benefits for American travelers.

The intermediate step, and one that is much more likely to be politically acceptable, would be to eliminate restrictions on foreign ownership or financial participation in American carriers, preferably, of course, on a reciprocal basis. Until the recent severe deterioration in their financial condition, under the influence of the Persian Gulf emergency and the slowdown in world economic growth or recession, some foreign carriers were apparently actively interested in making such investments.

I suggested over two years ago that there were the makings here of several possibly good deals, if we were to lift our restrictions. Foreign carriers were looking for American partners with whom to exchange traffic into and out of their international flights, for feed that they felt they required if they were to compete effectively on those routes with American carriers, which had the advantage, of course, of extensive domestic route networks. Meanwhile, several American cities that lacked direct international service were urging the Secretary of Transportation to let foreign carriers provide it. Among those cities I pointed out were Kansas City and Orlando, both Braniff hubs, before its demise. I surmised at the time that were it not for our restrictions, KLM, which had only shortly before the Braniff bankruptcy applied for the right to give Kansas City and Orlando their first non-stop trans-Atlantic service, would have been delighted to acquire Braniff and keep it alive for its traffic feed, if it were then granted the right to fly between those hubs and Amsterdam. But it appeared that that would be feasible only if it could also funnel traffic to and from those cities through its Amsterdam hub on to or off of one or another of the hundreds of international routes that it flies beyond. There just weren't enough people interested in flying only between Kansas City and Amsterdam to make the investment in Braniff worthwhile.

The Transportation Department flatly refused to consider any such extension of service. Braniff died, and we lost the opportunity to see whether we could have kept that service, that route network serving domestic travellers, and kept that domestic competition alive.

I am not in a position to assure anybody today, though I have made inquiries, that a TWA, or a Midway or a USAir could have its survival assured by a timely acquisition by a British Airways, or a Singapore Airways, or a Thai Airways, if those foreign carriers were free to acquire them, along with their domestic route systems. All I can say is that these restrictions on international investment, which could, of course, be conditioned by imposing or maintaining whatever national security requirements we chose on the acquired American carriers, make no sense whatever in an era where we are increasingly concerned about the sufficiency of competition to protect the American flying public. I would, of course, have any such acquisitions subject to the same antitrust test as we should have been applying all this time to mergers of domestic companies—namely, of course, we would prohibit them where the effect may be substantially to lessen competition.

It was two or three years ago that I publicly opposed British Airways being involved in the acquisition of United Airways. That was

not the kind of merger we needed. That was a merger of two powerful, clearly capable of surviving, international competitors or potential competitors.

Indeed, Congress might go farther and permit these acquisitions only where the effect may be to preserve competition, or to enhance competition.

In either event, it is clearly time for Congress to set us on the road to completing the job it began with its Airline Deregulation Act of 1978 and its International Air Transportation Competition Act of 1979, in the latter of which it set forth as its first goal the development of a negotiating policy which emphasizes the greatest degree of competition, compatible with a well-functioning international air transportation system.

Thank you.

Mr. OBERSTAR. Thank you very much, Dr. Kahn. It's so refreshing to have a witness come with zeal and enthusiasm, as well as the substantive and valuable knowledge that you bring to the subcommittee. Thank you very, very much.

Dr. Levine, welcome again. Please proceed.

Mr. LEVINE. Thank you, Mr. Chairman.

Mr. Chairman and Members of the House Subcommittee on Aviation, I am pleased and honored to be invited here to present my views on what U.S. international aviation policy should be as we move into what will be an important and exciting decade. Just for the record, I would like to state that I have served and continue to serve as a consultant and expert witness for a number of U.S. and foreign airlines. I appear today solely as an independent invited committee witness.

Please let me also state for the record a few facts about my background.

I am Dean of the Yale School of Organization and Management and William S. Beinecke Professor of Management Studies at Yale University. I have been a scholar of air transport regulation since the early 1960's and have written numerous articles and made numerous presentations on airline competition and regulation and on international aviation policy. In the late 1970's, I served as General Director, International and Domestic Aviation at the Civil Aeronautics Board. In this capacity my responsibility included all substantive staff functions except consumer protection, including international negotiations, international routes and pricing, domestic routes and pricing, and all agreements between airlines, including international rate-setting and computer reservations systems. After leaving the CAB, I served as Executive Vice President, Marketing for Continental Airlines, in charge of market planning, marketing and all customer service functions, and then served as President and CEO of New York Air, a new entrant airline, which moved from large losses to profits during my term as CEO.

No airline has reviewed my testimony, or is compensating me in any way for presenting my views today.

I said that we are entering an important and exciting decade in international aviation. The last decade might have been important as well, but U.S. aviation policy seemed almost designed to make sure it wasn't exciting! U.S. policy embarked on a very promising course, as Dr. Kahn has just mentioned, in the late 1970s and 1980.

In this brief period, unprecedented numbers of markets were opened to U.S. carriers and their foreign counterparts, producing the greatest expansion of U.S. international operations in aviation history and introducing foreign travel to unprecedented numbers of ordinary citizens, American and non-American.

Despite this promising start, U.S. policy lost momentum almost from the beginning of the decade. The supposedly procompetitive Reagan Administration pursued, apparently with the consent of the Congress, a narrow-minded, timid, and short-sighted policy. This policy, labelled "balance of benefits," apparently was adopted in response to those who saw the extraordinary growth and dynamism of the previous several years as threatening. Attacks on the previous market-opening measures took the form of criticism that the U.S. was being too open-handed by offering general access to the U.S. market in exchange for firmly guaranteed U.S. access to markets abroad. These critics apparently saw international aviation as a pie which had to be sliced and distributed to airlines with exquisite precision. So focussed did we become on exchanging perfectly equal slices that we ceased to notice that each new piece we exchanged was getting smaller and smaller. In the process, cities, regions, airports, and the travelling public were losing important opportunities. Equally bad, U.S. airlines were losing opportunities to fashion new international service patterns which complemented the domestic patterns and restructuring they were undertaking in response to deregulation.

Ironically, the avowedly free-trade, procompetitive administration of the 1980s managed to take American international aviation policy full circle back to the mercantilist and interventionist mid-1970s. The CAB, State Department, and Department of Transportation had worked together in reaction to the cramped and constricted "bargain" of Bermuda 2 to fashion expansive, dynamic, forward-looking policies. These policies provided both U.S. carriers and the traveling public with unprecedented opportunities. By the end of the decade, they had been scrapped in favor of Bermuda "2 and a half" and a series of other half-hearted measures which accommodated foreign needs while mainly preserving the U.S. status quo.

It is especially ironic that the balance of benefits policy that emerged in response to criticism of the open-handedness of its expansionist predecessor produced, like its counterparts of the 1970s, agreements (Bermuda 2 and Bermuda 2 and a half) which were the most imbalanced against U.S. airlines in the history of U.S. international aviation. Bermuda 2 substituted limited designations, capacity controls, and reduced American carrier Fifth Freedom rights for what had been a relatively open Bermuda 1 agreement. Bermuda "2 and one half" substituted two strong U.S. carriers for two others which were once strong but are now weakened in return for a promise to allocate to British Airlines virtually all future growth in the U.S.-U.K. market, at least for the next several years and possibly for far longer. This agreement in effect paid the British for the fact that British Airways and the independent British airline sector had become stronger, while Pan Am and TWA had weakened. In the process, it deprived the U.S. industry of further opportunities and some portion of the U.S. public of the benefits of international competition.

How did this happen? What are the challenges and opportunities now facing U.S. aviation policy makers? What policies should the U.S. pursue to best position U.S. policy for the 1990s?

To make sensible policy for the future, we need to understand the past. In general outline, the underlying causes of the past decade's international aviation policy weaknesses are pretty simple. In the late 1970s, after the debacle of Bermuda 2, U.S. aviation policy makers figured out some basic facts.

First, U.S. airlines as a group could be very effective competitors in world markets. This didn't mean that every U.S. airline would dominate every market in which it competed with a foreign carrier, but that on the whole, U.S. carriers could survive and even prosper against foreign competition.

Second, as long as this was generally true, one didn't have to answer the question, "for whom is U.S. aviation policy made—the travelling public or the U.S. industry?" On the whole, both would benefit from a procompetitive aviation policy. Even though individual airlines might suffer, the government didn't owe them a living at the expense of the general public, and there would be effective competitive U.S. airlines out there in an open environment.

Third, the fact that some foreign carriers could benefit substantially from open markets was both tactically and strategically important. It was tactically important because it meant that there were partners available with whom market-opening agreements could be made, and once those agreements were made, others would have to follow to avoid being left behind. It was strategically important because the U.S. could not possibly pursue a policy that benefited only U.S. airlines. Our trading partners had no incentive to agree to such arrangements and we couldn't defend them. The policy was credible as a matter of international relations and defensible from a political standpoint, both for the U.S. Government and for other governments, because it created the certainty of benefits for both the U.S. and foreign traveling publics and left open the possibility that both foreign airlines and our own might reap benefits and bear costs. No one could state with certainty that the game was rigged either in our favor or in favor of others. We created, instead, a relatively level playing field and let the public benefit from the ensuing contest.

This policy produced and was embodied in agreements with Belgium, Germany, The Netherlands, Korea, Taiwan, Singapore, Israel, Jamaica, and others. The regime they created was free and competitive to the point of being astonishing to veteran observers of the aviation scene. Aviation markets opened wide, producing remarkable growth and substantial benefits for those airlines, U.S. and foreign, that were adaptable enough to take advantage of them. Countries which wished to see trade and tourist traffic trade grow and countries willing to allow their airlines to face competition were willing to join with us in moving world trade forward. Perhaps even more important, countries which were unwilling to sign such agreements with us were obliged to adopt policies which opened their own markets so as to preserve the competitiveness of their own gateways and airlines.

No truly competitive process can guarantee that everyone is a winner, but many U.S. airlines did very well in the newly opened

markets and growth in those markets has exceeded growth in most markets that remained closed. In many of those markets, U.S. share actually increased, but this varied from market to market, as one would expect in a genuinely open regime. Airlines and their employees which had difficulty adapting to open markets complained, although regional officials and the public rejoiced. Airlines that did well took the policy for granted. As criticism from the losers mounted, the winners were seduced by the hope that they could keep or even enhance the gains they had made while somehow "pulling up the ladder" and preventing other airlines from pursuing the same opportunities. "They're giving away the store" was the rallying cry, and the Government locked the doors instead, opening them only to one customer at a time, and then only on the strictest of terms.

Not surprisingly, fewer "customers" were able to make deals with the U.S., and the market-opening process lost momentum. Rather than continue to move ahead bilaterally with those who were willing to trade freely, the U.S. began to support multilateral discussions which could be blocked or slowed by those who most opposed free air trade in aviation. We were never sure whether to heed civic and consumer interests who wanted more service and more competition, or to listen to those who were afraid of open competition. We wanted "fair" competition in which we always won. This option, not surprisingly, was unavailable. It takes two to make a trade, and no one knowingly makes a trade in which all the benefits go to the other side.

We stopped counting public benefits and counted only predictable gains to our airlines. In doing so, we dismissed as worthless the value of the opportunity to compete, and in so doing lost, not gained, bargaining leverage. Before, we could go to another country and say "We're willing to take our chances. Our airlines win some and lose some and both our publics benefit. You should do the same, and if you don't want to, we'll find someone near you who does." This was a game in which the size and value of the U.S. market gave us enormous credibility and in which our willingness to take a chance on opening it presented the other side with tempting opportunities.

We gave up this approach in the name of *realpolitik*, and ironically, we lost leverage. Worse, it turned out that we Americans weren't as good at horsetrading of microadvantages as were countries which had been doing it among themselves for decades. We ended up with the worst of both worlds—parsimonious deals which got us few public benefits, but in which we got commercially snookered over and over again. We could occasionally bully a small country which badly needed market access, and we would allow ourselves occasionally to do an even swap in a small way, but time after time—with the Italians, the Spanish, the Germans, the French, the British and the Japanese—we played the intricate game of benefits trading and we lost.

I suppose I should acknowledge here that on occasion, we showed a certain generosity to some smaller countries whose goodwill we needed on other counts, like Iceland, for example. But we consistently turned down imaginative market-opening deals when proposed and we consistently frittered away opportunities to make

bold proposals of our own, for fear of being criticized as too generous.

Yet another irony in this irony-filled process was that, as we became "tougher" and more constricted in our bargaining approach, we became less able credibly to consider tough counter-measures when we were in fact being taken advantage of under existing agreements. There is always another side to every international story, and when we attempted to preserve or extend existing imbalances instead of providing new opportunity, foreign publics were very ready to believe that we were throwing our weight around. This enabled foreign governments which were in fact keeping their publics from traveling and their tourist industries from growing to be seen as protecting national honor instead.

During the period when we were being openhanded and offering large opportunities to others, our apparent generosity made credible the possibility that we would feel free morally and politically to take retaliatory action against those who were keeping our carriers from doing business or who were threatening to restrict further our existing market-access rights. Those restricting us could not accuse us of wanting from them anything we weren't offering ourselves, or of asking them to take risks that we weren't willing to accept. And when they continued to pursue restrictive policies, they often had their own publics to answer to, once it became clear that the U.S. was offering the possibility of expanded travel and lower fares in exchange for market access by our own carriers.

By contrast, in the "balance of benefits" game, every foreign government could claim to be threatened by Goliath. Our size and prosperity have always made us vulnerable to Yankee-bashing, and it was a lot easier to be "the Japan (or the Germany, or the U.K.) that could say no" to a U.S. offering trades for narrow advantage than it was to do that to a U.S. willing to offer more open opportunity in return for a similar opportunity to compete abroad.

What are the opportunities that justify reconsidering our policies? First and foremost, this is an extraordinary period in modern history. Markets, relationships, even economic systems are being reexamined and replaced. Western Europe is moving, however, erratically, toward a single market. A single overarching political jurisdiction, seen as totally visionary a decade ago, now seems at least conceivable in Europe. We have a free trade agreement with a Canada which is struggling to reinvent its own political future. We are considering, however reluctantly, a similar agreement with a Mexico which is in the middle of profound change. Our relationship with Japan is in near-crisis, as we vacillate between insisting on a level playing field and on demanding that the fences, the baselines, and sometimes even the scoreboard be biased in favor of the home team. Australia and New Zealand, hitherto protectionist in the extreme, have made profound revisions in both their domestic regulatory policies and their external trade policies. I set aside as not relevant for aviation in the near term the momentous events in Eastern Europe and the Soviet Union, but they clearly will warrant serious attention at some point in the future.

What should we do to seize these opportunities? The U.S. should be bold and firm, generous and tough. We need to be able to insist on open markets to continue to manufacture opportunities for our

traveling public, our cities, our regions, and our airlines. We need to be bold in offering access to our markets, in order to make sure that our negotiating partners have incentives to deal with us and are under domestic political pressure to do so. We need to be tough in insisting that we get what we have already bargained for in doing business rights or in market access. We should be willing to terminate a bilateral agreement which is totally unacceptable to us and does not offer the prospect of progress, as long as our counter-offer is generous enough to obviate the charge of bullying. The United Kingdom terminated Bermuda 1, but we have been unable to persuade the British that the Bermuda 2 which resulted (and which they highly prize) has been at risk in any negotiation since 1980.

How will our own interests respond if we pursue the sort of policy that I am recommending here? It is human nature to want a good chance at what the other person has without being willing to risk what is already ours. Our cities want more open agreements, but are often unwilling to see tough bargaining tactics put existing service at risk. Our airlines are for opportunities in markets they don't serve and for protection where they already have adequate access. Our labor unions are frightened of foreign competition as is labor in all advanced countries, and like those other labor forces wants at the same time job opportunities in expanding companies.

We should be sympathetic and try to soften adverse impacts, but we should forge ahead. As long as we are opening new markets for all, we can resist understandable but parochial local and regional pressures. As long as airlines are getting access to new markets, it should be possible to insist that they accept negative impacts on those that they already have. As long as we have immigration laws and labor laws, airline labor need not fear competition on its home turf. Whether or not such competition has some foreign management or ownership, most jobs will be performed by Americans, just as they are in transplant auto industries. And we are a lot better when compared with others at running airlines than we are at making cars.

By now, you are all probably thinking, "this man is hopelessly idealistic". But consider the results of the "practical" policies of the last decade and compare them with the results of the "idealistic" policies of the previous three years. Do not merely compare the growth both of market size and of total U.S. participation in markets with 1978-1981 bilaterals compared to those with less open regimes (even though that comparison largely favors open regimes), but also consider what the performance of the markets which remained restricted would have been if there had been no open markets with which they had to compete. I believe that you will conclude that the combination of an open hand and a willingness to act against abuse is a much more practical policy than the green-eyeshades bookkeeping in which we have been engaged for the past decade.

What we discovered 13 years ago is still true; U.S. airlines as a group can be very effective competitors in world markets. Since this remains true, we can continue to pursue a procompetitive policy in the belief that it will benefit both the traveling public and the U.S. industry as a whole. We still can make progress by offer-

ing strategic aviation partners opportunities that will make protectionism difficult to justify to their own domestic constituencies and that will allow us to be insistent without appearing to be selfish or bullying.

We must act now to participate in and influence the enormous changes taking place in the environment affecting international aviation. We must attempt to create an open North Atlantic-North American aviation environment, being simultaneously willing to discuss a grand agreement and vigorously pursuing market-opening measures on a bilateral basis with whoever will deal with us. This means being willing to proceed generously and boldly with those willing to open markets now, while firmly refusing to be as generous to those who take advantage of that generosity to relieve pressures for more open competition.

Separately, we should move as rapidly as we can to establish a single aviation market in North America, first offering the Canadians with whom we already have a free trade agreement an opportunity to extend that agreement to air services. This would mean giving the Canadian airlines the right to create U.S. hubs to remedy the disadvantage at which their geographic location puts them vis-a-vis the centrally located hubs of American carriers. Of course, any such opportunity should be fully reciprocal. As our trade relations progress with the Mexicans, we should be willing to offer them the same arrangement.

These two measures, the North Atlantic and North America, will be mutually reinforcing. The prospect of being left out of the North Atlantic agreement will influence the Canadians. The prospect of being left out of a North American market will influence the Mexicans. The ability to offer access to all of North America in return for access to all of the European Community will facilitate agreement, and the ability (if that is how the timing works out) to offer a single important European state improved or open access to all of North America should enhance the possibility of making progress with the EEC.

The logic of generosity linked with firmness in pursuing open markets suggests answers to some much-discussed questions which currently face the U.S. For example, there has been much interest in the question of how much foreign ownership should be allowed in U.S. carriers. We should permit 100 percent ownership of U.S. airlines by nationals of states or regions with whom we have totally open arrangements. We should restrict more closely than at present ownership of U.S. carriers by nationals of states who insist on using nationality as the prime goal of airline competition, and should have in-between rules for those in between. In the same way, cabotage ought to be available to those willing to enter what amounts to a single aviation market with us, but we should be very firm in confining its benefits only to those who are willing to open markets completely. We should recognize that strategic considerations may influence with whom we are willing to move first in these matters. I should add that national security or labor market considerations should be addressed directly, that is, through special provisions relating to national emergencies, or relating to labor markets and immigration, rather than indirectly through trade restrictions, when we consider these issues.

In short, we should use the lessons of the past to face the challenges of the future. We have already experimented, however unwittingly, with both dynamic and static approaches to international aviation agreements. We have seen that a dynamic and vigorous approach works best, and that such an approach actually allows us to be firmer in protecting the rights of our carriers to do business abroad and to access other markets. We have seen that the seemingly cautious and pragmatic approach of the past ten years has disadvantaged our cities, the traveling public, and our airlines, and produced agreements "balanced" against us to boot. Air transport is an industry in which the U.S. can lead the world while the world gains benefits at the same time. Isn't that a deal we should embrace?

Thank you very much. I would be happy to answer questions.

Mr. OBERSTAR. It is indeed. Thank you very much for your also spirited and vigorous testimony, filled with insights into the past 10 years, and a view to the future.

As I said at the outset, I think we are poised on the threshold of a new advance in aviation. The decisions we make now, both legislatively and those that are being made now, and those that are being made on a daily basis ad hoc by the Department of Transportation are shaping that aviation future. It seems to me that we need to begin to further refine existing law with a view to more openness, more exchange, and to acknowledge in legislation the reality of certain developments like the concluding phase of the European Common Market. The full realization of benefits to which both of you have alluded includes the U.S.-Canada free trade agreement, the emerging Mexico free trading agreement, the emerging North America free trade market.

When I much earlier read your testimony, Dr. Levine, I had a marginal note about your first page seeming to indicate concern that the U.S. was trying to get equitable trade, but you were saying: "How can you have free trade if only one partner is free?" You redeemed yourself a little later on by addressing the matter of equal opportunities. That's the focus we ought to have. I think that you phrased that very well by saying we pursued a policy of balancing the benefits, but we really ought to be pursuing policies of equalizing the opportunities.

So, you then would feel comfortable with the thrust of our legislation. It says that we open our markets in proportion as other governments drop their barriers and open their market to investment to increased access. I'd like both of you to comment on that.

Mr. LEVINE. I'm comfortable with that thrust. I think that the provisions of the bill that I've seen described—I haven't seen the bill—perhaps don't go far enough in that respect. As I suggested in my testimony, I think that there is no reason to limit ownership of U.S. airlines in an environment in which other countries don't limit us and we have a single market. If we are all in the same market, there is no reason why you should care whether the money came from France, the United Kingdom, or the United States, and neither should they.

I think if we allow a fuller range, Congressman, then we are more likely to create pressures toward opening. It allows you to be more credibly tough against those who restrict when you say,

"Look, if you are really ready to open up, we are willing to go the whole way. We are willing to go as far as you can go". I would suggest that in that respect, the bill ought to be more open, or more open than what is currently proposed.

Mr. OBERSTAR. Dr. Kahn.

Mr. KAHN. I agree thoroughly.

It seems to me that the only thing I can add to that is a suggestion about attitude. I firmly agree with you about the need for reciprocity and defining it in terms of opportunities, rather than to try to measure the benefits and make sure they are equal. But, I think part of the attitude we also have to bear in mind is that we benefit by admitting foreign competitors to our markets. That is not something that we should give grudgingly or with hostility.

It is good for our own domestic economy and our own consumers. We depend, in part, on the flow of capital from abroad into our industry, generally. That's not, in itself, unhealthy. That suggests, therefore, a willingness to really be open in the way that Dean Levine is suggesting. I feel very strongly the same way.

Mr. OBERSTAR. The openness of investment up to 100 percent ownership of U.S. carriers provided the foreign government does the same—drops their barriers. It's a very, very attractive, and one that I support, frankly. It's a total open skies approach.

This subcommittee, as you know, had very extensive sessions in December last year with Canadian authorities—with their Parliamentary Committee. We met with then-Minister of Transport, Doug Lewis, and their two airlines, representatives of Canadian airline labor, and their community organizations. We had as thorough a review as could be had. Their Parliamentary Committee said it was better than they themselves had done. They fear U.S. domination of Canadian markets by our very big, powerful carriers. Their labor fears job losses if our carriers get into their markets and do cabotage, and that we'll be selective as to the most attractive, high profitable markets. Their other fear, which I raise and would like you to address, because I think it applies also to the Europeans, is that they will not be able to crack the U.S. market. They may be able to touch and skim the top of a few selected markets, but their carriers are not going to be able to develop hub and spoke support carrier systems. They are not going to be able to come into say, Minneapolis-St. Paul, and build a Canada airline to challenge Northwest airline, or any of the other support carriers to go out and bring the feeder services in. So, they say, "What value is it to us of that open regime when in effect, the monopolistic condition of hub and spoke, marketwise, keeps us out of the U.S. marketplace?"

Mr. KAHN. Isn't that part of the same problem of attitudes to which I referred? If the Canadians ask what benefit it is to them, are they defining "us" exclusively in terms of the interests of Air Canada? The kind of service we have between Canada and the United States is grossly deficient. We know that. The kinds of service between here and Ottawa—as I understand it, you can't go to Ottawa from Washington unless you go to Syracuse, New York. I can tell you, since I have to go to Syracuse all the time, I find it demeaning. It's the site of an inferior university, for one thing. [Laughter.]

If one is willing to define us in terms of the benefits to the traveling public, then that is overriding. Of course, ultimately, if the Canadians cannot bring themselves to open themselves up because of their fear of competition, then that suggests the kind of policy that Dean Levine was describing; that is, we'll go to like-minded people, and negotiate with them. That in turn would put pressure on the Canadians. That is what happened in the North Atlantic, for example.

Mr. LEVINE. I'd like to add a couple of things to that. First of all, although it's unlikely that at most U.S. hubs there will be more than one hubbing carrier, not every city which would like to have a hub already has one. Some cities which have hubs are worried about the prospect of losing them. It might well have been that Air Canada or Canadian Airlines might have been a buyer for TWA, or might wish to have a hub in St. Louis, whether they wish to buy TWA as a corporate entity or not.

There is no question that Canadian carriers face, I think, a very difficult choice, as I suggested in Canada, when I was up there speaking as a USIA visitor a couple of months ago. If the Canadian market is isolated, it is going to stagnate. It is already stagnating. Transborder traffic can only grow in a way that gives Canadian carriers an opportunity if they are willing to come down to the U.S. and carry north-south traffic in a geographically sensible way.

So, the answer for Canadians is, I think, best summarized as: Number one, there are opportunities in the United States, especially if we allow foreign ownership and control of U.S. airlines or allow foreign hub operations in the United States. Number two, consider what your alternatives are. If your own market remains isolated, it is not going to do terribly well. Three, as Professor Kahn was suggesting, countries that choose to stay out of a market-opening environment justifiably fear being left behind, and have an incentive to join the game. If we adopt a restrictive attitude and don't move markets ahead, no one has an incentive to play and everyone can stay where they are.

Mr. OBERSTAR. The reverse side of that is to take a line from your testimony, which struck me last night and this morning as I read it. We heard from the association or organization of Canadian communities who are looking for increased competition and, therefore, increased travel opportunities. You say that the Government didn't owe the individual airlines—speaking of our carriers—a living at the expense of the general public. We heard almost exactly that theme from the Canadian community. They aren't serving us in the way that we want. They aren't giving us access to the U.S. markets. What is air service for? It's not to make the carriers profitable, but if they become so in the process, that's wonderful. But, it should be to serve the public. So, we feel that the Canadian communities feel that if we have more U.S. carriers in our market, we'd have better service, and we'd have better access. Business benefits, both ways.

Mr. KAHN. Could I just underline one other point that Dean Levine made about hubs?

Mr. OBERSTAR. Yes.

Mr. KAHN. Certainly, in the general public, there is an excessive tendency to try to define the presence or absence of monopoly in

terms of the single city hub. The principal competition in the airline industry today, and it is very powerful competition, is over separate hubs. I mean, if I live in Minneapolis, I'm not going to have only Northwest available to me if I want to fly to Chicago or St. Louis or to Cincinnati, or to Atlanta, or to Dallas, or to Denver, because those are all places where there are other carriers. That gives them a niche, a protection in a way, but also provides competition. Moreover, if I want to go to any cities that can be reached through those hubs, including Salt Lake City, I know that I'll have a number of alternative routes.

Before coming here, I looked at my little pocket airline guide at the Boston to Phoenix route, which is certainly not one of the biggest routes in the United States. There are seven separate airlines serving Boston to Phoenix over their respective hubs.

Mr. OBERSTAR. I'll have some further questions. I do want to ask both of you your views on the trade policy that we have followed—our negotiators have followed over the last decade. My view is—and I would like your reaction to it—that we've expended too much negotiating capital on important but every day issues—doing business matters, ground handling, monopolies, gate access, usable slots, customs, immigration issues. We've spent an awful lot of time trying to extract comparable treatment from our foreign competition to that which we are affording them in the U.S., and insufficient time on the substantive issue of liberalization. I'd like to have your reaction to that.

Mr. KAHN. Mike, you know more about these negotiations than I do.

Mr. LEVINE. I agree as a general thrust that your statement is correct. That's part of the irony that I was trying to talk about in my testimony. I think that doing business issues are very important. Ironically, we can much more effectively protect those doing business issues if we are engaged in a large exchange of rights and, therefore, are in a position credibly to cut off someone who won't let us operate in an open way, because we know that there are other alternatives. We can be more forceful on those issues if we are holding out generous market access than if we look like we are just rifle shooting, because then it does look like we are bullying. If we come in and say, "We're going to cut off air service to Switzerland unless you let us perform our own handling at Geneva"—that's a very different kind of posture than to come in and say, "we're willing to open a significant hunk of the U.S. if you will open things further, but we insist as a condition to that on the right to do business in competitive ways. We want you to know, and we put you on notice that we think we are paying real rights for these things. Therefore, you shouldn't expect that you'll continue to have open access to our market if you do restrict us." That's a very different bargaining posture from—"well, we need three more counters at Geneva. We already give you so many hundred square feet at Kennedy."

Mr. OBERSTAR. Thank you.

Mr. Hobson.

Mr. HOBSON. I just have one brief question.

In looking and listening to part of your speech here, I want to make sure I understand this. I don't think that we are going to

wind up having ownership rights in any airlines in Germany or France. I just don't see those governments, no matter how hard you negotiate, doing that. I think these negotiations should be along the lines that if they are going to be allowed to invest in ours, they may give us some rights, but I don't see the practicalities of that happening, or our starting anything there. So, it looks to me like it is going to be a one way street on investment, and what we are going to negotiate is rights that are reciprocal. But, I didn't see that in your testimony. The way you talked, it was like we are going to be able to invest there.

Mr. LEVINE. I guess I'm not sure I'm as confident as you are that we won't be able to. The second and third largest automobile companies in Germany are U.S. owned. It's not obvious to me——

Mr. HOBSON. We don't make cars as well. That was in a different time.

Mr. LEVINE. Well, GM still does pretty well on the German market.

I think that there is no question that right now, the German government would make it difficult for U.S. interests to invest in a German airline. I think it ought to be an aim of our negotiating strategy to make sure that investment possibilities are a condition of opening markets. We had a pretty open agreement with Germany that we negotiated in 1978 and 1979. We gave the Germans much more rights in the subsequent decade than we were willing to insist for ourselves, partly because we didn't have the confidence to offer the Germany really open markets to the U.S. We went into a kind of micro-horsetrading, which we don't seem to do very well.

Mr. HOBSON. Do you think the investment capital would be there from this country to go into the German or French market?

Mr. LEVINE. I guess, the answer, Congressman Hobson, is I don't know, but I know that as long as the opportunities are there in both directions, that I'm pretty comfortable with what results. I don't think we ought to be balancing investments any more than we are balancing benefits.

Mr. KAHN. That's exactly right. We shouldn't single out a particular aspect of it.

This is purely hypothetical, but there is an enormous Germanic population around St. Louis. Suppose that we were to, in a tough-minded way, offer the liberalization or the opportunity, let's say, of an acquisition of the TWA route structure, but tough-mindedly insisting on a corresponding liberalization, not item by item, but in a broad way of opening up markets. Then it is entirely conceivable that we would have an opportunity that would be beneficial to both sides. We can't promise that. But, it seems to me that we could be both tough-minded and liberal in our goals.

Mr. HOBSON. I just have one last thing. I live in a hub area where we don't have other competition. I can't get here. I'm a captive of one airline to get here, and I live in a hub. I go 50 miles east of me, and I got another hub, and there is competition, and prices are a lot better.

Mr. KAHN. I must admit that I have to drive to Syracuse, which happens to be exactly 50 miles away. They have a tremendous amount of competition available to me, too. But, I have fresh air. I

live in a small community, and it takes me 10 minutes to get to work. [Laughter.]

Mr. OBERSTAR. We have a recorded vote in progress on the House floor on the Supplemental Appropriations Bill. We will take a 12 to 15 minute break to vote and we'll come back.

[Recess.]

Mr. OBERSTAR. The subcommittee will resume its sitting.

The Chair recognizes the Vice-Chair, the gentlewoman from Missouri, Ms. Horn.

Ms. HORN. Thank you, Mr. Chairman.

Dr. Kahn and Dr. Levine, I represent the St. Louis area that you've mentioned several times. It's one of our principal problems that we're dealing with right now, which is also a bit of a generic problem that happens to be the situation that we're dealing with TWA now. But, it's a generic problem that I believe deals with many airlines in distress.

Dr. Levine, you mentioned almost in passing the—and I'd like a little further explanation of when you talked about work force differences, and that restrictions are not the way to do that. You perhaps glossed over a little bit how that might be dealt with, with additional openings. I absolutely agree with you. We need to get there. How to get there from here with the least pain is my concern.

Mr. LEVINE. Would you like me to respond to that?

Ms. HORN. Yes, on the work force differences and how that might be dealt with.

Mr. LEVINE. My suggestion would be that one consider what one ordinarily considers with respect to immigration laws and labor laws. If Singapore Airlines buys a controlling interest in TWA, but under American immigration laws, they can't transport an entire labor force from Singapore or somewhere else to the United States, then they are going to run this airline with American labor, under American conditions. There may be a couple of vice presidents or whatever who will not have U.S. citizenship, but that strikes me as not the sort of problem we should be concerned about—I don't think we're talking about protection of vice presidential positions in airlines.

If you are worried about pilots and ground crew people, and so on, presumably, they will continue to enjoy whatever protection American immigration law and labor law give them now. The fact that the stock in the company or even the senior management is non-U.S. shouldn't affect that very much.

I understand that some labor interests are not terribly interested in improving competition in the airline business in the United States, because they think they will do better in an uncompetitive industry that has relatively few firms on which they can impose pattern settlements. My view is that it would be bad public policy to facilitate that. But, if you are talking about protecting jobs and making sure that Americans can work in the airline industry, it seems to me that the healthier the competition and the more viable firms you have, the more jobs you are likely to have.

Ms. HORN. We have 25,000 TWA employees imminently about to lose their jobs. They are in grave danger of that, so I don't think that's at issue.

I'm not going to ask any additional questions right now in the interests of time, as there are quite a few members here. So, I will pass this back to you, Mr. Chairman.

Mr. OBERSTAR. Thank you. The gentleman from Illinois, Mr. Lipinski.

Ms. LIPINSKI. Thank you very much, Mr. Chairman. I don't have any questions at the present time.

Mr. OBERSTAR. Mr. Poshard.

Mr. POSHARD. Thank you, Mr. Chairman.

I, too, represent an area that adjoins the St. Louis area. I want to just elaborate a little bit upon Congresswoman Horn's question. In listening to your testimony, both of you mentioned the idea of reciprocity which, of course, we are all interested in, if you go to the totally open concept of international business competition, and so on. But, as you know, this pervades all of American competitiveness and labor interests right now, not just the air industry.

As I see it, the way it is breaking down now, and the reasons for a lot of the labor unrest in our country is under this concept of open competition. The corporate profits increase tremendously, assuming that we are able to compete, and the consumer makes out very well with the increased competition. But, the labor force is the sticky wicket in this country. Now, it's not just a matter of protecting territory, it's matter of, at least in the minds of the laboring people, protecting their standard of living, of their quality of life right now.

If foreign ownership took over, let's say, they are going to operate under American labor law, but they are not going to operate under the present labor wage conditions that the unions and others have built up over a number of years in this country. They are not going to pay the \$20 an hour wages, let's face it. Now, what other nations in the world right now are we comparable to in terms of the labor rates; whereas, reciprocity would not be a problem, and what other countries of the world are we not comparable to? We would have to worry about this middle ground of the labor force affecting the ability to go to free open international competition.

Mr. LEVINE. We could spend a long time on this subject. But, at a minimum, I think it's not subject to argument that at least most of Western Europe, Canada, Australia, New Zealand, and Japan represent countries in which wage rates are essentially at U.S. levels.

Mr. KAHN. They're higher. So we're worried mostly about competition with Germany and Japan, and their wages are higher than ours.

Mr. POSHARD. So why doesn't our labor force know that then? Why are they fearing the loss of their jobs, then, if we go to this sort of international competition?

Mr. LEVINE. Well, some of the labor arrangements are probably not sustainable in almost any kind of competitive environment. If you have someone who is doing marginally skilled labor, and doing it for \$16 an hour, to take the people who are—I certainly don't want to debate American labor history—but if you take people who are handling baggage at Eastern Airlines for \$16 an hour, plus overtime, some of whom were making \$50,000 or \$60,000 a year, I don't know what arrangements you could impose as a matter of public policy that will under any kind of competitive conditions

protect the right of someone to earn that kind of money in that kind of a job. I really feel for the person who has to make a life adjustment, but I'm not sure that whole United States economy should be held hostage in order to protect those kinds of arrangements.

For some years, we had a regulated airline system in the United States that kept ordinary people from travelling, so that a relatively few people could earn very high wages under very unproductive labor conditions. I don't think that is fair. I don't think that is fair to working people. I don't think it's fair to the people who have learned that they can use airlines to visit relatives or take a holiday who use to regard airlines as something that you used only if you were very rich or if a close relative had just died.

Mr. KAHN. Of course, that also, it seems to me, is the attraction of trying to go the route in the airline industry of eliminating the restrictions on foreign investment in American carriers, because that offers, at least the hope of saving jobs. We don't seem to have trouble competing in the airline industry in international aviation despite the fact that our wages are very, very high in that industry. So, again, it isn't a case of our worrying about competing with foreign labor earning a dollar or two an hour. Our major effective competitors, as I pointed out are paying higher wages than ours.

Mr. POSHARD. In those skilled jobs, though, not the unskilled jobs—that's what you are talking about.

Mr. LEVINE. That depends on which countries you are talking about. To take countries I've actually seen, European labor costs in the airline business are probably higher than ours. They have on average less productive work rules than we do and pay wages that, on an average, are about as high as ours. In some countries, they may be somewhat lower. In Japan, I would say the same is true. In fact, Japan Air Lines is a higher cost carrier than any of its important American competitors. So, actually those countries tend to be more afraid of the prospect of competing with us than the reverse, although I do concede that there are some individuals who are concerned that any change in competitive arrangements will make their job situations more difficult.

I think one should emphasize what Dr. Kahn just mentioned. The United States airlines are among the most competitive in the world. We could probably have an interesting discussion over whether some Asian carriers from some of the developing so-called Asian Tigers, Singapore, Taiwan, etc., have wage arrangements that we can't duplicate. But, with respect to fully-developed countries, our carriers can compete with any of them. Our good carriers, our effective carriers can compete with any of them.

Again, although I want to avoid getting in the middle of some labor debates, if you look at the most efficient American carriers—Southwest Airlines, which is 90 percent union, has some of the lowest costs in the world. They have very productive labor arrangements.

Mr. POSHARD. Forgive me, for one more question, Mr. Chairman.

What are the specific fears, then, if we are competitive in that arena—what are the specific fears that are driving our policy to become less competitive in the international market arena?

Mr. KAHN. I think it's partly that—

Mr. POSHARD. I mean, why would we want to keep competition out then, if we are able to compete and we have the potential of opening up new markets, specifically?

Mr. KAHN. I'm sorry that I can't answer specifically. It is simply that no one likes to have competition in his or her role as a producer. Competition is always worrisome. The beauty of competition is, of course, that it is good for the public, it is good for consumers at large, and it ends up creating more jobs, not fewer jobs. But, it's not entirely irrational.

I am protected by tenure. At least, I used to be before I was put out to stud, or whatever the term is. [Laughter.]

Sure, the professors will defend tenure for some very good reasons, but partly because they don't like competition. That does not mean that it is the function of Government and public policy to honor that. The one thing that economists can say is that the extension of competition, just as they are discovering in Eastern Europe and in Spain, in Portugal, in Australia, in Argentina, and all over the world, is that that's where you get growth, then that's where you get improved welfare and opportunities. We are not going to end up being deluged with Mexican products. Mexico is our best market. But, no one likes to be discommoded. No one wants to have to change or to adapt.

Mr. POSHARD. Thank you.

Thank you, Mr. Chairman.

Mr. OBERSTAR. Mr. Sangmeister.

Mr. SANGMEISTER. I have no questions.

Mr. OBERSTAR. Let us project into the future, some eight or nine months, and assume that Europe of 1992 is a reality, and that the internal market has been created as Jean Monet and others envisioned. The United States and the European Common Market together are contemplating a new aviation regime. Seven of the nine carriers in that market are Government-owned. What should be our posture on cross-investment or trans-border investment?

Mr. LEVINE. I think we should take that concern very seriously, as the Europeans do themselves. As you know, in the Rome Treaty, there are provisions against State aids, which European countries invoke against other governments that they think are subsidizing competitors. We should be quite vigilant about that and take that very seriously. We should insist on the right to invest, which the Europeans provide for each other in the Rome Treaty, but more, insist that governmental practices that are designed to protect airlines they own, or money transfers that are designed to prop up airlines they own, be controlled by the international agreements that we make with them.

As a good start, we could construct provisions like those of the Rome Treaty that the Europeans themselves impose on each other. The European Commission has been fairly active. As you may know, the French government was slapped down for propping up Renault to the disadvantage of other European automakers. That was done by the EEC, not by us in a trade agreement.

Mr. KAHN. We have allies there. They just called the French government to account for a subsidy to Bull, the computer company. So, it's not as though we are the only virtuous believers of no subsidy. We have to confront the fact that the Europeans are not all on

the other side. There is a basis here for a deal and part of the deal would be that the playing field be leveled. There are people with whom we could work with in Europe exactly in that direction.

Mr. OBERSTAR. Well, the point I wanted to get at is, will the prospect of broader opportunities for investment in U.S. carriers, up to 100 percent, be sufficient to induce the EEC and require member countries to drop their barriers to investment to the same extent?

Mr. LEVINE. There is only one way to find out, which is to attempt to have that discussion, and I would urge that in addition, as I urged in my testimony, we continue to be willing to make individual arrangements with any European country that is willing to brave the heat from its EEC colleagues and talk to us. I think we have missed several opportunities in the past several years, and I regret that very much. There is no doubt that the clock is ticking down, Mr. Chairman. But, I am not as certain as some that that will occur in 1992, although I'm certain that it will occur.

Mr. OBERSTAR. Structurally, it will occur. In implementing the principles—and the Europeans are very good at decisions *en principe*, but are not so good at the details, which take much longer to carry out.

But, you may know that I did graduate studies in Europe at the College of Europe at the time of the formation of the Common Market. Many of my classmates continue to be very high ranking people in their own governments or in the EEC structures. I see them, and talk with them on a regular basis. They are very concerned about the development of a policy, within the European community.

EEC has not yet resolved the questions of cabotage among its own members, or transborder investment among EEC countries and disinvestment of Government in their national carriers. The EEC, when the Gulf War had such an effect upon travel, was to lower for their carriers the travel that our carriers experienced, and the French rushed in with an offer of \$400 million for Air France. The EEC took a "not now, this is not a very good thing to do" attitude, but had no real enforcement authority.

The question is, come January, 1992, can they move in the direction of resisting with enforceable means to prevent subsidies at key moments, and two, the denationalization of their carriers?

Mr. LEVINE. Again, there are two things. I think, first of all, we should not insist on multilateralism. I think one of the weaknesses of our policy over the past few years is that we've sort of sat on our hands, waiting for the Europeans to get their act together, so that they could turn and then talk to us.

Mr. OBERSTAR. That's a mistake of U.S. policy. I have privately in many public forums argued that we ought to cut out of the lot one carrier, one country and say, "We're going to negotiate with you, and offer you the best, most liberalized trading regime, and negotiate good and tough, and crack that facade, and the others will follow right after."

Mr. LEVINE. I couldn't agree with you more. I believe that there any number of Europeans who would privately tell you the same thing, because they are concerned about the lowest common denominator problem. If we wait for them to get their act together, they're concerned about what kind of a show they will put on. If

they have a great deal of time, those who are least interested in open trade and most interested in subsidizing their airlines, and most interested in controlling their markets will tend to control the process. Whereas, if we do what you suggest, Mr. Chairman, we are much more likely to begin to talk to the people who believe in open trade.

Mr. KAHN. We can influence what the European policy is that emerges, if we act aggressively.

Mr. OBERSTAR. Supposing on the other hand, the major carrier, like Air France, says, "We're not interested. We think you are flying too many operations into and out of France. We want less, not more, U.S. activity within our borders. We want to cut back this regime. We don't want it more liberalized."

Mr. LEVINE. There are very good restaurants in Brussels, and perhaps we can learn to speak Dutch or perhaps speak to the Swiss about what they would be willing to do.

The fact is, geography puts the United States in a pretty strong negotiating position, which is one of the reasons why it has to be careful to be generous as well as firm, as I was trying to suggest earlier. We don't want to throw our weight around and be perceived as bullies, but I think we ought to be in a position to say, "Look, we came to play, and if you won't play with us, we'll find somebody who will."

Mr. OBERSTAR. Let me move to one of the major issues of today's policy making by the Administration; that is, the sale of international routes. Those routes were given freely, out of the public domain, to serve the public and to use the air space that is—to borrow a phrase from another international regime—the common heritage of all mankind, of all humankind in the U.S. Then they can turn around and sell it for a profit. Now, that was a reprehensible policy, in my view, but it is there now, and it is difficult to roll that back.

How can that policy be managed and refined in such a way as to enhance, rather than to further restrict competition? Our legislation proposes one way of doing so.

Mr. KAHN. I'm very sympathetic to what you are proposing here. I guess we can get the question of principle out of the way first, as you have. It is absurd that we give rights, valuable rights, which then become private property of the people who have been the beneficiaries. We do this over and over again—use of the airways, valuable frequencies are given free. People then turn around and sell them. But, we're probably well past the point at which we can do much about that, in itself. At the moment it offers some hope, perhaps, of providing an infusion of cash that will keep some competitors alive. So, this is probably not a very good time to reconsider that policy.

But, the notion that there is a public interest in those transactions and that we should apply criteria of public interest, such as the interest of the antitrust laws, and that's embodied—again, I haven't seen your bill, but I've seen your statement of description of it. I think is unexceptionable that some portion of them can be reserved for use by people where it may promote competitive entry. We should have a right to say that you are not absolutely free to sell that to the highest bidder, if only because the highest bidder

will typically be the one to whom it conveys the greatest monopoly value.

Eastern facilities at Atlanta will, of course, be most valuable to a Delta, because to a Delta, it means protection against competition. To somebody else, it's an opportunity to compete with Delta. So, I have been much heartened by the fact that in the last six months, both the Department of Transportation and the Antitrust Division have inserted themselves in those processes. You're proposing that we go beyond that, and I strongly endorse that.

Mr. OBERSTAR. Professor, that may be the highest grade this bill has yet received. [Laughter.]

Mr. LEVINE. Harry Truman once asked to find an economist with just one hand, and I'm afraid I'm about to give you the other. [Laughter.]

I absolutely agree with what Dr. Kahn says. I think your concerns are proper and that they are grounded properly. I am a little concerned with this bill, however, as someone who has been an observer of the CAD and then DOT route award process, in terms of the way it works in the real world. I've seen the language of this bill, and I have a 3-D technicolor picture of what those hearings would require. I also think I have a fairly clear idea of how much the hearings would constrain the ultimate decision of the Department of Transportation, which is, I think, not at all.

If you go back to the glory days of the CAB, you can remember seven-year proceedings. This is now limited by statute, you'd still have a very long proceeding, at least as time is reckoned in commercial transactions. In old days of comparative hearings, there would be tons of documents. Then what would happen was that the CAB would meet behind closed doors and send orders down to the General Counsel's office and say, "This route goes to Delta, that one goes to United, that one goes to Eastern." The lawyers would sift through all those documents, and could always find enough in the documents to justify any decision. The people who were involved in the process became very, very cynical about it.

They are still at the DOT, and I don't think the language of this bill would make them more idealistic. I think that what would happen is that you would accumulate a record on all of the seven or so factors—I can't remember the exact number—that were to be considered. Then the Secretary would go ahead and structure the transaction in a way that, if he or she had a decent General Counsel's office, would be more or less irreversible by the courts. The factors you are concerned about might well have little to do with the real grounds for the decision. So, I don't see how that advances the ball.

The real question is that right now the statute imposes a public interest test on route which has functioned as kind of a smell test. Unfortunately, we haven't had a Secretary of Transportation in some years who has had a nose. [Laughter.]

Mr. OBERSTAR. Well said.

Mr. LEVINE. Recently, the present Secretary has discovered what the use is of this device on the front of his face, and I thought that what the Department did with respect to the American purchase of the TWA routes was quite sensible. I thought, frankly, what the Justice Department did with respect to the transfer of gates and

slots at National Airport was sensible, and I approved, also—for what my approval is worth, but I approved also of what they did with respect to the Eastern gate transfer to USAir in Philadelphia.

So, I think there is adequate statutory authority now, both in the Justice Department and the DOT, with respect to international routes, to make sure that those assets are transferred at least in a way that doesn't do maximum damage to the public interest, I'm not sure that we can ever be sure a particular transfer maximizes the public interest, as there are a lot of competing considerations and these issues are very messy when you actually see them in front of you on paper.

I think the real question is, how can you get the Department of Transportation and the Justice Department to take the concerns you have raised seriously. I frankly doubt that putting the language you propose into the law will make any difference in that respect. Whatever has influenced the Department in the last six months to become more interested in these issues, it hasn't been a change in the statutory language. If you put that statutory language in, and we get a Secretary who wants to go back to the way things were a couple of years ago, your a seven-fold test will just increase the length of the hearing and run the lawyers' bills up, but it won't affect the transfers in the end.

Mr. OBERSTAR. Dr. Kahn.

Mr. KAHN. As I said, I have not read the statutory language. But, I think in principle, it's terribly important to distinguish the kind of exercise of judgment that the CAB felt called upon to make in the past under regulation, in which it had to judge what was the public interest. It would weigh who could give the greater convenience to the greater number of travelers. Certainly, that's a nightmare that we wouldn't want to dream of going back to.

But there is and has always been an antitrust philosophy, which does not involve that kind of pervasive substitution of Government discretion for the market, but simply says where we think the effect may be to impair competition, then there is a public interest which overrides the interest and the right of the private parties. How one then defines doing the pro-competitive policy and distinguishes it from the kind of pervasive regulation that the CAB did, is something I'd like to think about in terms of what language would do that best.

Mr. LEVINE. That's in the current statutes. I mean, I think the most effective thing you could do, Mr. Chairman, would be to find ways to move aviation policy toward opening more markets. The routes which change hands and are the most valuable are those routes which go to places with which we have the most restrictive agreements—the U.K., where Bermuda 2 limits carriers to one per route, and two to a couple. The routes to Italy are valuable. The routes to Japan are valuable. The routes to countries with which we have open agreements like Germany have no resale value. The gates or slots at Frankfurt Airport might have value. But, the routes have zero value, because any airline that wants to get into that market can, at least as a matter of statutory right.

So, we ought to be concerned first to make the routes less valuable by making the right to fly available to as many airlines as want it. Then you get the gates and slots, and there I agree with

Dr. Kahn and I agree with your intentions. I think the Government should be concerned about competition.

Mr. OBERSTAR. Coming back to your well-stated point that the Government doesn't owe individual airlines a living at the expense of the general public, what we are looking for is a way to re-institute, in the buy/sell process, that very public interest—maybe if not these particular standards, then some standards by which to hold the Secretary accountable, by which the public can hold him measurable. It may well be in the final analysis that he doesn't have the will, that he can't find his nose, that the particular deals don't smell, or some of the perfume gets in his way.

But, the same issue is there for the Justice Department. They can decide or not decide to enter or convene on a particular proposition that appears to be a restraint of trade, in violation of the Sherman Antitrust Act. If the sale of Eastern's slots at National had gone the way the market was going, or the way the bankruptcy judge wanted them to go, you'd have had a clear monopoly control of National Airport. The intervention was appropriate to spread this out. Just try to do the same thing with the sale of a route. If a few more of these deals of international route sales cook, then we won't have anything to talk about. There will be two or three carriers doing international travel.

Mr. LEVINE. I agree with you. I testified against the original Pan Am route transfer to United in the Far East, when that was up for DOT approval in the mid-1980s and urged the Government to consider parceling the routes out to make the market more competitive. But, that was something to the Government could do then, and that's something the Government can do under existing law.

Mr. OBERSTAR. There may be a distinction in these route transfers of—and I'm thinking of the situation where a carrier has received the right to serve a route, but didn't use that right, did not expend dollar one for development of that route, and then turns around, sometime later, and sells what, in effect, has been dormant authority—shouldn't there be an obligation upon the Department to look behind that deal, to look at the carrier who is next in line in the competition for the route, rather than let this carrier acquire a huge profit for having done literally nothing except win the award?

Mr. LEVINE. I think that is a very clear case where there is no social merit in allowing the sale. I think the real question is, whether a transaction can take place reasonably quickly; whereas, having an elaborate comparative hearing might not allow the asset to be used. The question is, will you end up with something different in the end? I guess I would argue that all those rights, all those concerns, are already embodied in the present law. The question is, will the President appoint and will the Congress hold the feet to the fire of a Secretary of Transportation who is worried about those kinds of things?

Mr. OBERSTAR. I agree with that. But, what we're trying to do is separate personality from position, and put in place a statute that gives direction and guidance. Under existing law, for example, I think it could be stated fairly that in the American/TWA transaction, the Department was merely deciding whether American could

serve that route better than TWA. It didn't bring other carriers into the consideration, or into the equation.

Mr. LEVINE. I agree. But, in the International Fair Competition Act, the one that Fred said he was last here testifying about on this subject, there is a preamble that makes a very strong statement that U.S. aviation policy is pro-competition. There is already provision for public interest intervention into route transfers that presumably allows the statutory purposes to be effected.

I don't think, Mr. Chairman, that we are at all disagreeing about whether the Government should be worried about this.

Mr. OBERSTAR. Or how to make it work.

Mr. LEVINE. I really am very skeptical that enacting the sorts of things that are in this proposed bill into law will do anything other than increase the size of the record and pose more delay on transactions, and ultimately make the process seem even less defensible than it may seem now.

One of the worst prices, I thought, of the old CAB regime, was the pervasive cynicism that surrounded the route award process. Nobody seriously believed that routes were being awarded on some sort of scientific or merit basis. What was going on was arbitrary and the General Counsel staff at the CAB prided itself—and they were very competent lawyers—on the fact that they could write any opinion and make it stick in the D.C. Circuit.

Mr. OBERSTAR. In the final analysis, the best deal would be to have no limitation on the amount of service in and out of a country, therefore, routes do not in and of themselves acquire value, and they become valuable only insofar as the carrier develops that route.

Mr. LEVINE. I heartily endorse that.

Mr. KAHN. That, of course, is the essence of deregulation, that the certificates are not legally scarce and, therefore, don't have a monopoly value.

Mr. OBERSTAR. I have a final observation, and hopefully you'll have a response. Many observers, foreign as well as U.S. carriers, say that while international aviation is, indeed, highly competitive—look at all the carriers who are moving between Japan and the U.S., U.S. and Europe—is it so? How would you characterize the level of competition?

Mr. KAHN. Well, it varies.

Mr. OBERSTAR. In other words, is it realistic to measure it simply by the number of carriers competing?

Mr. KAHN. Of course not. You could have a cartel with a large number of members prohibited from engaging in, let's say, price competition, in which you may have very, very wasteful competition of other kinds. So, you'd have to look at the legal framework, the regulatory framework, within which they operate. From that standpoint, obviously, there are enormous variations in the international sphere from one route to another, depending upon the applicable Government policy. Some of them are really very highly competitive. Others remain very, very profitable. The willingness to pay \$300 million or \$400 million just for the right of access to an airport tells you something, very eloquently.

Mr. LEVINE. I think that is correct and I think some of the more valuable, more restricted markets are not quite so obvious. Italy,

for example, is a market which is highly restricted, which has not grown as rapidly as many other markets to Europe, because the geography of Europe tends to isolate Italy from the circumstances we were talking about earlier where if you can't get there one way, you can get there another way. It's a long train ride to Rome. That's probably one of the least competitive markets in Europe on a trans-Atlantic basis.

The U.K. market clearly is not as competitive as it could be, but it is constrained somewhat by the existence of alternatives in Northwest Europe that will presumably be even more valuable once the Channel Tunnel is opened. The markets that are the most competitive, not surprisingly, are the ones in which there is open competition and easy substitution of airports—Brussels, Amsterdam, Frankfurt, and places like that.

Mr. OBERSTAR. Thank you.

Mr. Clinger, any questions?

Mr. CLINGER. Thank you very much. I'm sorry that I was not here to hear the earlier dialogue, because I found the presentation fascinating, very challenging, very stimulating, and very exciting.

I have just a couple of things on my mind. We talked about how the idea to have total free access, so that the routes would not have any value. But there are restraints on that, aren't there? I mean, the fact is that you do have to land at airports, and there are limitations on how many planes at any given time period can land there. I call it artificial, but it is a physical restraint that makes it really more difficult to do that.

Mr. LEVINE. Absolutely, and some Government policies encourage or allow their national carriers to make sure that nominal access rights are not actual access rights. The German Cartel Office apparently has no concerns about the fact that Lufthansa is busy setting up hubs at every airport in Germany that looks like it might be able to accommodate competitive service in Europe. You have the extraordinary spectacle of hubs at Cologne and Frankfurt, which are 100 miles or so apart, and Lufthansa first trying to buy into Interflug, which is the East German carrier. They are now trying to make sure that Lufthansa gets to operate at Schoenefeld Airport in East Berlin before British Airways or somebody else can get in. They are not very hospitable to American carriers, either.

The British have had an airports policy designed to make sure that British Airways faced the weakest possible competitors at Heathrow. There is plenty of work for someone who wants to open markets in Europe that goes beyond simply the exchange of route rights.

Mr. CLINGER. Right. With regard to that, you indicated your skepticism about enacting new legislation in the area of routes or slots or whatever. But, there is one area where, in fact, there is a limitation, and that is on foreign investments at the present time. If we are going to change that, it is going to take legislation in order to make that possible. I've introduced a bill to that effect. I put a limit on it, mainly for political reasons, because I think there is concern about the buying of America, and so forth. But, I would agree with you, I really don't see that there needs to be, except that, what do we do in the case of an airline that is nationally

owned? I mean, is there any concern that you have that Air France, for example, would be investing in this?

Mr. LEVINE. We had some conversation on that.

Mr. CLINGER. Oh, I'm sorry.

Mr. LEVINE. There is provision in the European community rules that expresses the concerns that European countries have about each other's behaviors in respect to subsidizing competitors. I think we should be concerned also, and we should make sure that what we do contains rules against "state aids" and requirements for reciprocal open access.

Mr. KAHN. You see, that's another example of what we were saying that we can, by taking an active policy, affect what happens in Europe. As I understand it, the Common Market authorities have, in fact, ordered the Belgium Government to agree to stop subsidization of Sabena. I certainly don't understand all the circumstances, but there are influences within Europe, as Michael was suggesting, that we could be working with. Part of the reciprocity would have to be the undertakings of avoidance of Government subsidization, for example.

Mr. CLINGER. Which is something that I think we are contemplating here.

Now you said, Dr. Kahn, that the idea of reciprocal investments—or there should be reciprocity of investments preferably, but you indicated that that might not be necessarily a requirement. Would you say that you would allow sort of free investment whether or not we got reciprocity?

Mr. KAHN. Well, I was betraying my prejudices as an economist. The benefit that we get from foreigners investing here or foreigners selling in our market is a benefit that is really independent of whether we invest there. We benefit to the extent that we have more competition here. Now, we benefit even more to the extent that we also have corresponding opportunities. You get beyond economics to a question of, what is good strategy? To what extent should you threaten to deny yourself the benefit of competition from foreigners in order to exact from them a corresponding reciprocal opportunity, which is the best of all possible worlds?

I regard the situation in the American industry as very frightening right now. I'm reluctant to make as an absolute condition—if somebody really comes in and says, "I'm willing to acquire TWA," or, "I'm willing to acquire Braniff," as I suggested might have happened two years ago. "I'll keep it alive because I want the feed." Then for us to say, "Now, wait a minute, what can you give us in exchange?" You are already giving us something. Now, it happens that the one that was interested or might have been interested in Braniff was KLM, who already had a very liberal Government policy. That was the reason for the qualification of my statement. But, of course, I don't have to run for office. [Laughter.]

Mr. CLINGER. Thank you.

Mr. OBERSTAR. Well, yes, and on that score, we observe with your reference to tenured professorship that Eugene McCarthy once observed that, "The last bastion of full freedom of expression in the United States is a tenured professorship."

Thank you very, very much, both of you. It was a splendid contribution.

[Mr. Kahn's prepared statement appears on page 485.]

Mr. OBERSTAR. Our next panel includes Mr. David Treitel, Executive Vice President, SH&E, Inc. and Ms. Judith Trent, Managing Director, Global Aviation Associates, Ltd.

Again, we have two superstars of the aviation investment community, or sector, two people whose impact on aviation in the practical world of investment is as significant as that of the theoreticians, who just left the table.

Mr. Treitel, welcome, and thank you very much for being with us. I might also observe that he is a practitioner of the art of investment counseling and investment decision making where consequences are very immediate, very direct, and very heavy. You have been one of the astute participants in that scene. We appreciate your participation here today.

TESTIMONY OF DAVID H. TREITEL, EXECUTIVE VICE PRESIDENT, SH&E, INC.; AND JUDITH TRENT, MANAGING DIRECTOR, GLOBAL AVIATION ASSOCIATES, LTD.

Mr. TREITEL. Mr. Chairman and members of the subcommittee, I was delighted to receive your invitation to appear, and I appreciate the opportunity to express my views.

Since I joined SH&E in 1977, I have been involved in several hundred different airline assignments in the United States and around the world. My clients have included U.S. and foreign airlines, entrepreneurs, manufacturers, financial institutions, and Government agencies.

Recently, I have been involved in many assignments which contributed to the consolidation of the U.S. industry, helped privatize several foreign carriers, and also several of the U.S. carriers. I have assisted a number of industry participants in responding to the changing structure of the airline industry.

I appear today on my own behalf. While my clients may concur with these views, they are my own.

My remarks concern two key issues: foreign ownership of U.S. airlines and cabotage. I believe that U.S. international aviation policy must allow foreign interests to purchase larger stakes, even controlling stakes, in U.S. airlines. The U.S. airline industry has enormous capital requirements in the 1990s. These requirements are so large that traditional capital sources will not satisfy them. Foreign capital, particularly equity capital, is a new source of capital that can be tapped to fill the U.S. industry's capital shortfall. This shortfall, we estimate, may be as much as \$12 billion per year in each of the years of the 1990s.

The corollary to foreign ownership is, of course, cabotage. Provided that the U.S. Government ensures that their are equivalent and reciprocal opportunities for U.S. airlines, cabotage is a vehicle which will open new markets for U.S. airlines, create additional job opportunities, and control labor cost increases.

I'm just going to summarize some of the reasons for these views.

Boeing recently published their annual current market outlook. In that, Boeing estimates, and we have done similar work, that \$16 billion per year will be required by the U.S. airlines to re-equip the U.S. airline fleet. The U.S. scheduled carriers have \$165 billion of

aircraft on option and on order. United has \$45 billion of aircraft on option and on order. American, Delta, and Northwest each have more than \$20 billion on option and on order.

If you allow for the other types of capital—ground equipment, facilities, airport gates, computers—the industry will require nearly \$22 billion per year in each year of the 1990s.

Given the size of today's U.S. airline industry, and the level of profitability that it has historically achieved, normal or traditional capital sources will only satisfy \$9.5 billion to \$10 billion of that \$22 billion requirement. In other words, new capital sources will have to be found to satisfy the industry's capital requirement. Those sources will include asset sales. They are likely to include an increasing leverage of our airline industry. They are also likely to include perhaps tax credits, operating leases, and other forms of lease finance.

The only real new source, that I can see, is foreign airlines and foreign equity investments in U.S. carriers. To date, there have been some, but one has to admit that the returns on the foreign airline investment in U.S. airlines have hardly been adequate. Delta has been invested in by Singapore and SwissAir. Those returns have been marginal, at best. Ansett's investment in America West has been a very unattractive one. SAS' direct investment in Continental can hardly be called a smashing success. KLM's investment in Northwest is also worth much less today than the \$400 million that KLM invested in it two years ago.

There are obviously strategic reasons that will amplify the direct returns that these carriers have made. SAS/Continental, for example, as a result of a marketing alliance and a shifting of service to Newark from JFK, was able to increase its New York/Scandinavia service to four flights, from three; provide connecting service within the U.S. to 85 cities, compared to 63 at JFK; and in the first half of 1990, transport 40,000 connecting passengers compared to 25,000 prior to the arrangement with Continental.

These benefits are obviously ones that are worth a great deal and will offset some of the capital losses that existing investments or past investments have made. What they also show is something very similar to what happened to the U.S. airline industry with respect to their regional carriers, where ultimate control had to be achieved in order to protect the benefits of those strategic alliances. That's why most of our U.S. airlines own their own regional airline partners.

I want to just shift quickly to talk about the U.S. airline productivity and efficiency, and why I believe that cabotage is in the interest of our industry, provided it's supplied in a manner that is equal and reciprocal for both U.S. and foreign carriers.

The United States airlines are the world's strongest competitors. Virtually without exception, our airlines produce seat miles at a lower cost than the foreign airline counterparts. Work that we've done and I've included in my remarks are some graphs that will show that the U.S. airline cost curve is 20 to 25 percent lower than the comparable cost curve of our foreign airline counterparts.

In terms of U.S. labor, the U.S. airline employees are the most productive in the world. Despite a relatively high average employee compensation, U.S. airline productivity is well above that achieved

by our foreign counterparts. Again, on Figure 4 in my written remarks, it shows that the U.S. airline labor force produce seat miles 60 to 75 percent more productively than the work forces of the foreign airline counterparts.

In terms of how well we compete, our airlines are extremely effective competitors. Over the last five years, in virtually every world region, with the exception of Europe, which I'll discuss briefly, U.S. airlines are achieving premium market shares. These are the carriers that have innovated and developed the complex fare structures which cater to each market segment. These are the carriers which have developed the CRSs which have automated and changed the way of distributing airline tickets. These are carriers which have innovated and developed the yield management systems and the frequent traveler programs. The frequent traveler programs really have reinvented or set a new standard for brand loyalty systems in American industry or in any industry.

In the U.S.-Japan market, for example, over the last five years, U.S. carriers have gone from a market share that is less than 50 percent to a market share that is well over 50 percent. Even in carrying Japanese citizens, five years ago, the U.S. carriers had 38 percent of the market. Today, they have 53 percent of the market. With U.S. citizens, that share has increased to over 75 percent of the market. When given our chance, our carriers are the world's most competitive. Cabotage will certainly result in U.S. carriers gaining more than we will lose at home.

Just to summarize my remarks, in terms of foreign ownership, U.S. international policy needs to be altered to encourage the flow of capital to our industry. We need that capital to help the industry replace an aging fleet. Laws that restrict the level of U.S. ownership by foreign parties should be altered like the proposed legislation does, so that the U.S. airline industry can attract more equity capital.

Some of the policies that Secretary Skinner set forth last year, in my view, really don't go far enough. The limits on voting controls are obviously statutory, but the limits on non-voting equity of 49 percent of total equity do not go far enough. There is no need to restrict that. There is no need to restrict the capital markets from developing investment securities that respond to the needs of the industry.

With respect to cabotage, as long as our carriers are given the same opportunities as foreign carriers, or reciprocal opportunities—that's not to say, Manchester, England, in return for the entire U.S.—but something of equal value in terms of market access and market size. Our carriers are likely to have many more expansion opportunities, and more jobs will be created. Indeed we will have the benefit of a more competitive market at home, where we can control labor cost increases and other cost increases.

Mr. Chairman, thanks for the opportunity of expressing my views.

Mr. OBERSTAR. Thank you. Of course, your complete testimony, including the charts will be included in the committee record.

Ms. Trent, welcome, and thank you very much for your participation. You also bring a very long and distinguished career in avia-

tion, with lots of experience, both in the Government sector and in the private sector. We welcome your presentation this morning.

Ms. TRENT. Thank you.

Mr. Chairman, members of the subcommittee, I appreciate the opportunity to appear before you today.

I am currently the Managing Director of Global Aviation Associates, which is an aviation consulting firm with the main office located here in Washington, and staff in Brussels, Geneva, and London. Previously, I was Assistant Secretary of the Department of Transportation for Policy and International Affairs, and also was Assistant Secretary for Environment, Safety, and Consumer Affairs. I have also been employed by Pan Am and TWA.

It will perhaps surprise you that I am one of the persons who was in the early years of the Reagan Administration, to whom Mike Levine was referring, I'm sure. The surprise is that I agree with him in almost everything he says. Even more surprising is the fact that I haven't changed my views.

As a long time participant in the field of aviation, I have watched the industry making a slow and sometimes painful transition from being a highly regulated industry to one that is mature in its ability to compete, as mentioned by Mr. Treitel, and, for the most part, is anxious to do so. I believe the trend toward open markets is the correct one. I believe it is inevitable, and should be permitted to progress as rapidly as possible, without undue regulatory constraint, but within the normal public interest tests that apply to all other industries.

I am not alone in this belief. Today, I would like to tell you briefly about the results of a series of sessions that were held last year under the auspices of our European offices, to consider the economic regulatory impediments to the expansion of air transport services. Members of the group, which has been referred to as the "Think Tank," were admittedly of the more liberal persuasion. They included the Chairman, Hans Raben, who is the former Director General of Civil Aviation for The Netherlands, as well as representatives from U.S. airlines (specifically, American and Delta), airlines from Europe and Asia (UTA, ANA), and former Government officials in aviation from the U.S., U.K., Ireland, and Australia. A list of the individuals who participated in the deliberations of the Think Tank is contained in the final report, copies of which I have provided to the committee.

The origin of the Think Tank was in the Chairman's original suggestion that a group of people get together to take a fresh look for solutions to the restricted aviation regulation that was occurring in the international field.

The group came to the following basic conclusions.

First, free trade policies are being applied around the world, and deregulation of domestic air transport as we see in several countries is merely a part of a much more widespread and general move towards the withdrawal of governments from the regulation of industry and commerce. Air transport liberalization of domestic markets is a coming reality in North America (specifically, U.S., Mexico, and Canada), the European Community and Australasia (specifically, Japan, Australia, and New Zealand). As many as 40 airlines around the world are moving towards private ownership.

This move towards the privatization of airlines has diverse motives, but a change in political philosophy is certainly encouraged by a need to escape from the obligations to provide very large additional investments in fleet renewals, particularly if there is reason to suspect that the air carrier is less than efficient in its operations.

In sum, the case for freer trade is gaining increased acceptance throughout the world and greater liberalization in international aviation policies is widely accepted to be better than protectionism.

The second issue that we looked at is whether bilateralism is the way to go or continue along that track or towards multilateralism. Our fundamental observation was that the traditional system of aviation regulation, namely bilateralism is constraining the growth and development of air transport. The airline industry has matured. Its markets have been global and interdependent, and the marketplace changes with increasing speed and growing complexity. In short, the bilateral system is too cumbersome for today's global market-oriented airlines, and unsuited for a mature industry.

Bilateral restrictions on market entry, price, and capacity have been easing over the years, but the process is slow, limited in scope, bureaucratic, and costly. With global markets opening as a result of a phenomenal increase in trade and travel, bartering for air rights on the terms of the most restrictive bilateral partner is increasingly out of step with the needs of the industry and the dynamics of the marketplace.

Therefore, we turn to multilateral negotiations as having wider scope and a better prospect for future liberalization.

The multilateral, which the Think Tank advocates, requires the opening of domestic markets to foreign competition and an acceptance of the possibility that nationally-owned airlines may be losers in the free market. This may be viewed as a revolutionary idea for the airline industry, certainly for those in most parts of the world, if not here in the United States, but these conditions are accepted as the norm in many other industries in which transnational ownership has prevailed for many years.

Finally, it would be an unsatisfactory outcome if the creation of a liberal regime led to the elimination of competition, the reduction of effective choice, and the domination of the industry by a powerful worldwide oligopoly. One of the basic requirements of a liberalized regime, therefore, must be the inclusion of effective competition rules and machinery with teeth for their enforcement.

Among the elements of a liberal multilateral that we saw were, first of all, within the area covered by the agreement, any airline of a contracting State would be free to operate air services—scheduled or charter—between any points designated as international airports with no restriction on capacity or frequency of services. Any controls retained should be strictly related to technical or financial fitness considerations or to enhance the use of infrastructure. Moreover, rights on routes within contracting states (namely, cabotage) should be included in this market access freedom, though this will become less important when ownership and establishment rights are liberalized.

In pricing, all controls should be eliminated subject, of course, to antitrust policies.

Provisions must be included to prevent anti-competitive agreements, predatory practices or abuse of dominant position. They must also provide for the elimination of subsidies and State aids.

Non-discriminatory rules and codes of conduct would have to be agreed for such matters that provide fair commercial opportunities, with which we seemed to get bogged down to an extreme degree in today's environment.

Fundamental to the success of a freer trade regime for air transport is the abolition of the concept of "substantial ownership and effective control" by nationals of each State. The multilateral must allow ownership and control to be in the hands of nationals of any contracting State.

Last, but not least, the membership of the multilateral should be open to any State willing and able to abide by its terms of the agreement.

So, the issue, of course, is how do we get there from here. We recognize that there will have to be transitional measures, but would hope that they could be kept to a minimum.

We examined environments such as the ICAO and GATT, and for a number of reasons, existing environments and organizations and institutions appeared to carry too much baggage to be useful.

It would appear to us that the best possibility for substantial liberalization in the near term is through arrangements between smaller groups of States with common aviation philosophies and market interests, or what we would call an expanding bilateral. Indeed, moves towards regional liberalization of this sort in Europe, North America and Australasia is regarded as encouraging for multilateral liberalization.

While the critical need is for the liberalization of passenger services, we do believe that the most distinct economic and operational characteristics of all-cargo services provide possibly for an earlier opportunity. The elimination of constraints and the consequential increases in the efficiency of cargo services would greatly benefit producers and customers throughout the world. And, not the least of considerations, all-cargo operators are, for the most part, seeking such liberalization in order to improve their competitive opportunities.

As you know, Mr. Jeffrey Shane did testify in this direction in his March testimony, and I applaud his efforts to work towards an all-cargo regime. He refers specifically to express freight, and I would hope that DOT would expand beyond that in its thinking.

In addition, in view of the fact that the report of the Canadian House of Commons Special Committee on Canada-USA Transport Services specifically suggested that an open skies agreement in all-cargo might be desirable, I am hopeful that the governments will pursue this idea on a fast track, rather than run the risk of having it bog down in the time frame and larger issues related to combination services. Such an agreement, if obtained, could conceivably provide the model for subsequent agreements with other countries.

The Think Tank did want to put forth an action plan. Obviously, the most important thing was to convince governments of the advantages of liberal multilateralism, including all of its elements. The hearings today are an encouraging move in the direction of providing a forum for the open debate of these ideas. As stated

before, we believe the trend towards liberalization is inevitable as trade and tourism markets expand, and governments loosen their grips on the ownership and regulatory control of air carriers.

The Think Tank is hoping that this process will move rapidly. We are doing all we can to encourage governments and industry to go through the windows of opportunity that will be presented in the coming months and years. In addition, we would like to see positive action taken toward convening working groups and conferences that will produce the first multilateral document and members for the agreement. This could be with the U.S. and Canada, the U.S. and Central America, the U.S. and the EEC, or the EEC and Asia. Wherever it occurs, it can't be soon enough to accommodate the needs of the market and the interests of the consumer.

This concludes my prepared remarks. I would be happy to answer any questions that you might have.

Mr. OBERSTAR. Thank you very much for a very broad treatment of the issues that we are considering during the course of this inquiry and which are addressed in the legislation that we've introduced, and for also providing us with the document produced by the Think Tank. It's quite a distinguished list of people, at least a couple of whom I know.

Ms. TRENT. Yes, you do.

Mr. OBERSTAR. I note that on the first call of the recorded vote, the question, first of all, Mr. Treitel, is there a market effect of the bill that the committee leadership has already introduced? Have you noticed any sort of market reaction to legislation of this kind?

Mr. TREITEL. With respect to foreign ownership, in particular?

Mr. OBERSTAR. Yes.

Mr. TREITEL. I frankly don't think that the bill goes far enough. I think that the limit on 49 percent voting control of U.S. carriers probably isn't sufficient inducement to really attract the kind of foreign investment that there has to be in our airline industry.

Mr. OBERSTAR. So, investors are not reacting to this?

Mr. TREITEL. If the control provision is relaxed, with 49 percent for effective control, that would be fine. But to make it appealing, you want to have the situation—just to draw an analogy with SAS, where SAS was really not in control of what happened or what might have happened at Continental, that situation really can only be avoided again if, in fact, in respect to what the actual voting limit is, that the control provision is removed.

Mr. OBERSTAR. Now, would you say the same, that there really isn't any market effect so far, at any rate, of people reacting to the proposals that we have with respect to sale of international routes?

Mr. TREITEL. The sale of international routes is sort of different. I don't really know yet if there has been any market effect. We have done several assignments recently with regard to international routes. Ultimately those may or may not lead to a sale. I think that with respect to the proposed legislation, there may need to be a distinction between routes that have been developed and nurtured by carriers for a long period of time, such as the London routes of Pan Am, the London routes of TWA, and perhaps routes which were given and quickly sold, such as on the Seattle/Tokyo route, which Continental basically hadn't even operated for a year. Yet, they were able to sell the route for \$150 million to American.

Mr. OBERSTAR. Before the airlines went on this massive investment escapade, for want of a better term, surely they had some thought of ~~where~~ the money was coming from. You've described for us the shortfall, of being what's available and what they need, and that on an annual basis, some \$21 plus billion is going to be needed, there is a \$9 plus billion capability in the marketplace, and we are wondering where that is going to come from. Didn't they think about that ahead of time?

Mr. TREITEL. The airlines had made arrangements, but they weren't the traditional forms of finance. The arrangements that had been made are principally from the manufacturers. Boeing and Douglas have tremendous sort of potential liabilities of financing all the aircraft that they are producing. In Europe, the aircraft that are being made are being sold and being supported effectively by very low export credit types of financing where, in essence, the manufacturers are setting up acceptance corporations and are creating their own financial institutions in order to finance the delivery of the aircraft that are on order.

It's still not going to change the thrust of the matter, because the prudent measure of leverage has to rise. Just to make up that shortfall, financing will come from the manufacturers, in part or other things, but the amount of leverage and the amount of debt on the balance sheets of our carriers is going to rise.

Mr. OBERSTAR. What I'm getting at is, is there—and Ms. Trent, maybe you want to comment on it as well—whether the airlines are, in fact, over-extended on capital investments and whether the market is.

Mr. TREITEL. I think the likely effect is going to be that many of what are actually not orders but options will not be taken, and the gap will also be narrowed by less aircraft, and less investment in the industry. Ultimately, carriers will decide, instead, not to replace aging fleets. They will fix the aging fleets. So, we will not see all of the benefits that a year or two ago, many of us thought that there might well be.

Mr. OBERSTAR. If markets improve, travel improves.

Mr. TREITEL. Yes, and if the carriers make more money, that fixes all the problems. But, it just doesn't work that way. [Laughter.]

Mr. OBERSTAR. Are there specific actions Government can take to enhance investment opportunities for acquisition of aircraft as required?

Mr. TREITEL. Well, one of which, that I was talking about here is foreign ownership. That will create a new source of capital for the industry. That's something that has several beneficial effects. It not only creates, but brings more capital into the industry, it allows it to re-equip. It probably lowers the effect of cost of capital which, from a policy standpoint, is obviously, very desirable. It might ultimately result in more capacity for consumers, and more capacity means lower fares. So, that's one that I think is a very, very positive direction. Beyond that, I personally don't see things that I would want the Government to be doing to encourage investment.

Mr. OBERSTAR. Investment tax credit?

Mr. TREITEL. Generally, I don't see that the airline industry should be given special treatment in that respect.

Mr. OBERSTAR. It would distort investment opportunities in the marketplace.

Mr. TREITEL. In effect, we already have that happening, particularly with the Europeans, with the export credits. I was mentioning to Judith before, I have a client, who is a Mexican carrier, that effectively has a cost of capital that is well over 20 percent, who buys airplanes with debt provided by the manufacturers at 9 percent.

Mr. OBERSTAR. We'll have to suspend at this point and take about a 15 minute break for the vote, and then we'll return.

[Recess.]

Mr. OBERSTAR. The subcommittee will resume.

What basis is there for expectation that lowering or modification of the U.S. ownership requirements will induce European, or other areas—the focus, principally, has been on Europe—investment in U.S. carriers, to improve their liquidity position or improve their opportunity to acquire new aircraft, especially in light of the difficulties that the industry has had in the last year?

Mr. TREITEL. I'm not sure that we can point to a specific basis that there will be investment in U.S. carriers. I'm certain that over a period of time, as the industry goes through its vicissitudes, that there will be periods where the opportunity will be sufficient to attract a carrier or another foreign type of authority into investing in U.S. airlines. Obviously, right now, with the U.S. industry having just experienced losses on the magnitude of \$4 billion, this would not exactly be put as the most attractive business to be investing in.

There will be some strategic investment, potentially, but even there, I wouldn't expect it, nor would I advise that it necessarily be directed at the carriers that are in or on the verge of bankruptcy. I would advise my customers or my clients to look more towards the healthy U.S. carriers that are sort of at the bottom of the cycle, so that the investment opportunity would produce a high return.

So, I think the opportunity enough is one to attract additional investment, and that opportunity itself over a period of time will work to attract investors when the value appears to be greatest.

Mr. OBERSTAR. Is it only foreign carriers that would be interested in investing in U.S. carriers, not other investment conglomerates?

Mr. TREITEL. Foreign carriers are the most likely, but are not the only ones that may do it. They are the most likely. I know that over the course of the last 15 years, we have been approached by several parties that are not carriers, that are not U.S., that have an interest in airlines and airline-related investments.

I'd like to point to, perhaps, a different area of the world, in Mexico, where Mexicana is privatized. The investors in that enterprise include Sir James Goldsmith, Chase Manhattan Bank, and The Drexel Latin America Investment Fund. All are owners of Mexicana. So, where foreign investment was allowed outside of the U.S., it attracted non-airline investment. I think that the same sort of opportunities, if afforded to foreign interests in the U.S., are likely to ultimately result in the same kind of activity.

Mr. OBERSTAR. Now, we have a provision in our legislation, reciprocal lowering of barriers, reciprocal liberalization. How significant

is that? What is the likelihood that U.S. carriers are, in any way, interested in investing in a Sabena or a Lufthansa or SAS or any one of the European carriers?

Mr. TREITEL. Well, they already are. We know that. Delta has already invested in Swiss Air. Delta has already invested in Singapore.

Mr. OBERSTAR. Beyond a very marginal amount.

Mr. TREITEL. Exactly, but there are likely to be similar types of answers in order, as expansion opportunities for U.S. carriers are indeed limited. The reason I say that is, you can see that already the fact that American airlines are spending \$445 million to purchase the opportunity to serve London. They spent \$345 million to purchase the opportunity to serve Latin America. So, we know that the interest is there to broaden the horizons and take advantage of the economies of scale and the economies of scope, find places to take advantage of the B scales, and find places for the new aircraft that are on order to operate. So I think that over the course of time, reciprocal opportunities are a great thing for our carriers.

I happen to not also think that it is not necessary, and that some of the benefits of foreign investment in U.S. carriers will be derived even if our U.S. investment continues to be limited in foreign carriers.

Mr. OBERSTAR. But, it seems to me that the principal in foreign carriers investment in U.S. operators would be to buy their way into the U.S. market at a relatively or comparatively low cost, as compared to having to buy or establish the infrastructure themselves to serve a hub and spoke type of operation.

Mr. TREITEL. It's really a make or buy decision. If it's cheaper to make it, you make it; if it's cheaper to buy it, you buy it. At the moment, our carriers are cheap. They are definitely cheap. There may be interest, as a way of access in the U.S. market, to buy it rather than to make it.

Mr. OBERSTAR. Ms. Trent, what do your Think Tank people see in the investment opportunities, or what I would call reverse investment, of U.S. carriers in European operations, in view of a 340 million population market in a much more concentrated geography than we have in the U.S.?

Ms. TRENT. If I may, I'll speak for myself, since their position is that investments should flow where they will, and we should not put barriers up to it. I think you asked about inducement for investment. One of the inducements clearly now is to purchase access in ways that you may not have it and marketing strategies that you may not be able to otherwise have.

That is certainly the purpose of the Delta/Singapore/Swiss Air purchase. They felt that in order to cement a marketing arrangement, "put your money where your mouth is", so to speak, cross-investment would guarantee that they would then have the commitments that they would want to have in terms of cooperating in the market.

My own view is that if rights were to flow with those purchases, we'd see more of them. I think that if a foreign air carrier were actually to be able to use rights from a USAir, for example, if it were able to buy into USAir and actually carry passengers on

USAir as cabotage passengers, there would be much more interest in that kind of purchase.

The same is true of U.S. carriers. I agree with David. Right now what airlines are doing is buying limited routes. But if we were not to have those limited routes, then U.S. carriers would be trying to buy their way into markets by purchasing foreign carriers. Nobody is going to buy anything for awhile, obviously. I mean, we are just suspending it under the current reality principal, I think.

I found it rather interesting that we all worked ourselves into a frenzy about foreign investment in U.S. carriers when our carriers were at their very worst, and nobody could imagine why anyone would want to invest in most of them. We did spend a lot of time talking about whether or not we should permit foreign purchasing in carriers that were failing. Why would anyone want to buy a failing carrier when there has been evidence that they can't make the market work for them as it is? Why would a foreign carrier think it could do better, particularly when, as everyone has testified this morning, U.S. carriers are more efficient in the production of seat miles? So, why would a foreign carrier think it could do it better? It can't.

But, there would be a time, I think, when we see a strong market again, and that U.S. carriers could look conceivably very closely at trying to get into the European arena by purchase of a carrier in Europe and the same would be true here. I don't think it's out of the question.

Mr. OBERSTAR. Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman.

I think the statement that you just made—in fact, I've made a little note here, a \$350 million market, as the Chairman mentioned, at least as a market for them to come into, that lost \$400 million last year—why would they want it? I think that is a very valid question.

I probably should have a little bit more background information on this question, but I probably already know it. How long has it been since you would consider that the airline industry has been a profitable investment for anybody, how many years?

Mr. TREITEL. It sort of depends on how you at it.

Mr. HANCOCK. There are a few individuals, I understand, because of LBOs and what have you—there has been some big bucks made, but they got out. Then they unloaded on somebody else.

Mr. TREITEL. I'm going to give it sort of a longer time period. Most of what is called the profitable or the healthy U.S. carriers over the last 10 year period have provided returns to the stockholders, in terms of dividends and capital gains, or capital appreciation of their stock. It has exceeded the return on the market as a whole. Certainly that was true up through 1989 and before the start of this current recession.

In the period of 1978 to 1989, the returns afforded the stockholders of America Airlines was quite attractive, and exceeded 20 percent per annum. It was the same with USAir. Similar returns that were not quite as high were achieved at Southwest, United, and Delta. So, over a long period of time, they have been returns that investors have been attracted to or awarded handsomely with above average returns. Since 1989, of course, the industry's returns

afforded to investors have probably been close to the worst in the American industry.

Mr. HANCOCK. Are you talking about returns to the investors from a standpoint of the capital of the market appreciation, rather than actual dividend return?

Mr. TREITEL. Correct. I'm not distinguishing. Certainly after the last Tax Act, there is no reason to distinguish between dividends and capital gains.

Mr. HANCOCK. That brings up another subject.

I just got here to the hearing, Mr. Chairman, and I appreciate being able to ask those questions.

Thank you.

Mr. OBERSTAR. Thank you.

You've addressed, David, the capital requirements of the U.S. air carrier industry. But, the Europeans have had the same—I shouldn't say the same—but they have capital investment requirements, but not of the same magnitude. Their market is very different. KLM, for example, is pretty much an international carrier, so the 747s they have are fewer in number. They the total fleet of a U.S. carrier. They don't have that domestic service to attend to. But, have you examined the capital requirements of the European carriers and what their investment plans are or needs may be over the next decade?

Mr. TREITEL. Yes, I'll go through that with the Europeans and the Asians and the important distinctions between the two.

Asia, of course, is a very rapidly growing market. The returns or the profitability of air services in the region is very much higher than anywhere else in the world. That's true for the U.S. carriers that serve the region. That's true for the carriers that are operated within the region. The high profit margins that are produced means that, in fact, more capital can be accessed from internal operations than is normal throughout the rest of the world. Cathay Pacific earns margins that approach 30 percent per annum. For a U.S. carrier to do five percent per annum would be an exceptional return. So, the capital shortfall and the capital problem, even without the Government support that many of the carriers have, is not anywhere near as troublesome in that region of the world as it is in the United States.

The answer in Europe is different. Margins are similar to those earned in the United States. The growth rates are slightly more rapid. But the fleet ages are much younger. So, whereas, the United States carriers over the next decade will be replacing 44 percent—or of the new aircraft that will be acquired, 44 percent will be used for replacement. That percentage is much lower in Europe. So their ultimate capital requirement is much smaller, and the differential of the capital shortfall, as a result, is very small, indeed, from normal sources.

Mr. OBERSTAR. Plus, they have governments backing them up in the final analysis.

Mr. TREITEL. Absolutely, and I think that the other thing that will happen which as we go through it is those carriers are slowly being privatized. Government ownership of those carriers is slowly shifting to the private sector. We've already seen British Airways go private. As that process evolves—and speaking from our own ex-

perience in advising carriers and advising governments about the privatization of their carriers, the process of fixing a carrier or making it profitable or making it attractive is one that is likely to result in a lower capital requirement for those airlines. So, the governments are likely to assume some of those responsibilities as they convert their ownership of their airlines to the private sector.

Mr. OBERSTAR. There is an infrastructure issue that I have several times referred to. I would like to get your thoughts on it. That is, the impact of infrastructure in Europe on aviation. They have one fourth the airspace of the United States, twice as many air traffic control centers, and an outmoded, to be charitable, technology guiding aircraft, at all altitudes.

In addition, their ground infrastructure is very different from ours. High speed train service and short distances that can be easily covered by automobile make it very attractive for governments to guide investments and make marketplace decisions. The French government has decided as a policy matter that distances of 400 kilometers or less will receive Government subsidy for high speed train service. For distances between 400 and 1,000 kilometers, investments will be guided on a competitive basis as to what makes best sense in that particular route, air or high speed rail. For distances over 1,000 kilometers, the policy is to subsidize or, as they say, to invest in air service.

How do those decisions impact our trade considerations with Europe? Do they distort in any way the trade picture? I'll ask both of you.

Mr. TREITEL. Judith?

Ms. TRENT. To the extent that we have a debate about infrastructure here in this country, it is mild, relative to the debate that is going on in Europe. I think that they are moving away from public ownership of their airlines, without question, but they are facing massive investment in the infrastructure. Part of the European community assignment is one of trying to determine how that infrastructure will be renewed in the next decade.

There are all kinds of public interest groups as well as airline groups trying to force those decisions as rapidly as possible. They are not unlike ours. We are simply going to have to face up to the fact that ground and air services are going to be the limiting factor in the future. In some way, in building in our views of the future, we must make determinations as to how they will be fairly allocated, not just to domestic operations, but to international operations as well. To date, we have simply said they must be opened to all international operations, and we are seeing increasingly that there is not enough space to do that.

So, part of any kind of scheme for the future with respect to a regulatory environment or a policy for negotiations will simply have to come to grips with what reciprocal access on the air space means in the future.

Mr. OBERSTAR. Yes. Mr. Treitel.

Mr. TREITEL. The importance of strained infrastructure is one that we can really draw an analogy here in the United States, where effectively airport constraints limit entry, limit opportunities for expansion, and constrain the rate of growth of the entire structure. The European environment has a much greater problem

at the present time than we have here, in terms of the constraints on the transport sector. Also, it's a much more costly problem.

Currently, the operations, the Euro-control situation with landing fees at many of the airports are outrageously high, contrasted to those in the United States. Indeed, the application of, say, Article 10 of many of the bilateral agreements between the United States and foreign countries is one that is very difficult to do. It's one that requires the support of the State Department. We're going through it now with the landing fees at Heathrow Airport. It's one that is effectively a 10 year process to institute. It indeed is a problem and will be a continuing problem in the disparity of the cost of operating and the difficulty in getting access to many of the European airports and many of the Asian airports.

Mr. OBERSTAR. That infrastructure issue bothers me very, very greatly. We have, as you understand, a very highly developed infrastructure and we embarked upon a course of vastly improving and substantially enhancing air traffic control with a \$25 billion investment over the balance of this decade with some \$50 billion of airport capacity enhancements through the legislation enacted last year.

The Europeans, the Japanese, and the other Asian carriers all have access to this market, this increasingly more sophisticated technology and infrastructure. Then our carriers go into their backyard, and find that Spanish air traffic controllers won't take French aircraft, or aircraft from France, unless they have a telephone call from a French air traffic controller. It's unbelievable.

How can we—of course, our carriers are going to be operating under the same limitations that their carriers are in their market, but what I'm saying is, I think the equities are unbalanced in the two marketplaces.

Ms. Trent, your Think Tank associates have focused on multilateralism as the wave of the future as a better vehicle for liberalization and bilateralism. I would like to see us move in that direction. But, I don't see very much evidence of multilateralism taking root in the European community, other than decisions in principle that have been made, but not backed up and not supported by concrete actions of Government or of the European community. What comments do you have on that?

Ms. TRENT. I think that is correct, but I'm not discouraged by what I see in Europe right now. If we recall, the industry in Europe was adamant that the Treaty of Rome did not apply to it.

I believe that the Nouvelle case was just a few years ago. Since the industry had to come to grips with the fact that the court was going to rule against it, then lo and behold, it came out from under the tent and said "we'd better do something about this." In my own opinion, change has actually been moving quite rapidly, needless to say, with the Commission prodding the industry in the process.

But, I think that we will see increasingly a move towards the multilateralism framework within the community itself, including cabotage and ownership. I think the industry will just simply have to come to grips with that, and they will, or they will be taken to court.

Mr. OBERSTAR. Can we push that process along by actions of our Government?

Ms. TRENT. I was just going to say that one of the things that has disappointed me, and this was mentioned by Michael Levine—as I said earlier, I agreed with just about everything Michael said, except his criticism of the Reagan Administration. [Laughter.]

I can give him some reasons for that and have, but I'm not convincing enough yet.

I am disappointed that our posture has been to say that when you are ready, come and talk to us. I just don't think we can do that any longer. I've greatly heartened recently to read and hear Secretary Shane commenting that it is time to take some initiatives.

I fear that the Canadian initiative will backfire, but not for reasons that are U.S. policy, but because of the positions that the Canadians are in. I do feel that we should be out taking the initiative along the lines that Michael Levine says, which is to essentially say, "We're prepared and we want to come and talk. We are going to come over and see you. We're going to talk to you about what an open skies agreement or a liberal agreement or a multilateral agreement will look like. We have some drafts. We have some proposals. Will you sit down with us in some extended period of time and discuss what that would look like." We haven't done that. We have been waiting for the community to get organized. They will get organized, and it is going to be harder.

Mr. OBERSTAR. Very good. That's a view that I wholly subscribe to, and I think we should have carved out one of the European countries and sat down and negotiated a very liberal regime with them, and attempted to put that into firm language, and then see what the other countries do. I think we could force their policy more than they could do internally with each other. After all, they really do want access to the U.S. market. It is a big drawing card.

Ms. TRENT. It is going to be incremental. This is why one of the suggestions I made in my remarks and the Think Tank makes is, let's grab the cargo initiative, not because the initiative is primarily to de-regulate our international cargo relations, but rather in the course of developing that cargo language, you are going to have to come to grips with things such as what the access article will look like. What will the infrastructure articles, the doing business articles and all look like if indeed you have to guarantee some kind of reciprocity?

It isn't just that that itself is such a wonderful thing, but if we just get going on a few of these things and get a few good minds going at them so that we know what we're talking about, then I think there is some possibility to progress. But if we just sit back and say that we're here when you want to see us, I just don't see it. It is just going to take forever, I think.

Mr. OBERSTAR. I have a further and last question, and that is on the provision in our pending legislation that deals with the sale of international routes. What market effect is there likely to be from the further refinement of existing law that we would propose in this legislation requiring the Secretary to look at other considerations that impact on competitiveness rather than simply the market value of the route as ascertained by a negotiation between

a purchaser and a seller and the impact that the sale would have on those two carriers? Can I get your thoughts about that?

Mr. TREITEL. It seems to me that almost always you'll have somewhat of a noncompetitive effect when a route sale is involved. The buyer is going to want to earn a return on investment that was higher for him or her than it was for the previous owner of the route. So you have a situation where you have somewhat of a noncompetitive impact—actually noncompetitive is not the technically correct term—there is an additional cost of serving a route that will have to be provided for in return. You're likely to have a somewhat different competitive environment as a result of a changed cost structure.

As far as the use of proceeds go, I'm not sure how it's possible to effectively administer legislation that requires a continued use of proceeds to be directed to aviation or the continuance of a carrier's interest in aviation. I don't know how to distinguish between one dollar from another dollar, to be quite precise. The dollar in my right pocket looks and feels the same as the dollar in my left pocket. I don't know how we can distinguish between the sources and uses of that capital.

Ms. TRENT. The comment I would like to make is that it seems to me that one thing that we want to make sure is that the Government does not have any chilling effect on the actual ability to transfer assets to the most efficient operator of those assets. I think that having any kind of controlled presentation of proposals will merely duplicate the situation that Mike Levine so aptly described at the CAB, which has now been transferred to DOT, where the process of making route decisions is one of rubbing your head and patting your tummy after you've made the basic cut that three or four carriers can operate the route. Once you have made that cut, then how you come down to which one of the carriers actually gets the route becomes very, very marginal. It's one that can be argued very competently in either direction.

So, I am a little concerned that we not try to duplicate that, but in a different kind of environment. Say that we're going to let carriers buy/sell routes, but now they have to buy/sell in a public form. Presumably, the seller has looked for the best buyer. Presumably, the seller wants to maximize the return, has looked for a bunch of buyers, and has come up with a buyer that will pay the most. It seems to me that that sale then should be carefully perused by the Justice Department for its antitrust implications, which the Justice Department is increasingly getting involved in. I applaud that. But, I think that to go beyond what's in the current law could become burdensome and that would worry me very much, as a procedure.

Mr. OBERSTAR. Well, the antitrust authority is important, but it is a rather blunt instrument and not refined and not necessarily attuned to community interests or needs. The Department has not been particularly interested in who is the most efficient, but who can pay the best price for this route and only passingly has looked at the effects upon competition of a route sale.

In the long run, while we can talk about these in an abstract sense of economics and the pressures of the marketplace as to who is the most efficient operator, that person sitting out in Interna-

tional Falls, Minnesota, or Brainard, Minnesota sees the number of carriers being reduced further and further, and has fewer opportunities to travel, or fewer choices and options. He eventually points the finger at Congress and asks what we have done about this. What have we done to keep competition alive? Where is the public interest in all of this?

I think that is another element. That air space belongs to all Americans. The right to serve is something that is conferred by the public for the public interest. Yes, I think market decisions are very important. What we are saying is that there should be a market decision, and then when the market is established as a value, then the Department should look at which of the carriers should offer the opportunity to serve and match that price in order to keep competition alive.

Mr. TREITEL. There is a bit of a problem with that.

Mr. OBERSTAR. Yes.

Mr. TREITEL. In the sense that the carrier willing to pay the most, obviously, expects to earn the most on it. The one that expects to earn the most is the one that is likely to be able to charge the highest fares, or operate at the highest load factors. That carrier effectively believes that it is going to be able to operate in a manner that perhaps is somewhat more or less competitive than the other carriers that are willing to pay a lower price.

By allowing price to effectively determine or the marketplace to determine the value, we are in a sense authorizing noncompetitive or potentially noncompetitive behavior. The only one willing to pay that price is presumably the one that can operate in the most non-competitive manner.

Mr. OBERSTAR. My reading of route sales over the last five years is that the ultimate departmental judgment has been that this sale will help the selling carrier survive. It's not so much what is it going to do for the buying carrier. It's going to help this carrier survive in some other way and on a smaller level. Pan Am is going to dump those specific routes. But that money will help Pan Am stay alive. So, now, we're to the point where Pan Am is selling its London routes. Well, that is going to help Pan Am survive and stay alive.

This prompts the story that in the year 2010, there will be three carriers left in the world. That will be British Air, Aeroflot, and the struggling Pan Am. [Laughter.]

The decision has been made on the wrong side of the equation. If this carrier decides that it can't service that route and needs to sell, then who can best serve the route? Who can best provide the continuing competition? That's judgment we'd like to see brought to bear.

Mr. TREITEL. That's true, thus far, that virtually every route sale has either been connected with a carrier that is in bankruptcy and has effectively been decided by a bankruptcy court, or a carrier that was doing it to stay out of bankruptcy. So, in all cases, you have a condition where the seller needs to sell. In essence, a free market is not or a truly fair market is not operating.

Mr. OBERSTAR. I have one final thought or observation. Does your testimony, Mr. Treitel, suggest that traditional sources of capital

investment for the airline industry are drying up and that we need to find some other sources to bridge the \$9 plus billion gap?

Mr. TREITEL. Yes, but it's what I consider to be a temporary situation where the traditional sources of capital are more difficult to access. That has to do with credit conditions and the decline in used aircraft values. Longer term, the shortfall is due more to an increasing capital requirement for U.S. carriers as they replace their fleet. Whereas, in the 1980s, 28 percent of the new aircraft of the U.S. carriers operated replaced older airplanes. In the 1990s, 45 percent will be replacing older airplanes. So, we have a combination of needing capital for growth and needing capital for replacement. That has increased the size of it and, consequently, it's not that there aren't new sources of capital, it's just that those sources that were funding a certain level aren't able or aren't big enough to fund the new requirement, which is much higher.

Mr. OBERSTAR. Thank you. Are there any other comments?

I want to thank both of you very much for your extremely valuable insights into aviation policy and issues today.

[Mr. Treitel's prepared statement appears on page 552.]

[Ms. Trent's prepared statement appears on page 571.]

Mr. OBERSTAR. Our next panel is Mr. Mark Atwood, Counsel for American Trans Air, and Mr. John J. Maloney, President and CEO of Florida West Airlines. I'd like both of you to come forward, and thank you very much.

Welcome, gentlemen. We appreciate your being here with us and being very patient throughout the interruptions today that dragged out our schedule longer than we anticipated. Your entire statement will be included in the record and you may summarize as you wish, or you may deliver the entire statement as prepared.

TESTIMONY OF MARK W. ATWOOD, COUNSEL, AMERICAN TRANS AIR; AND JOHN J. MALONEY, PRESIDENT AND CEO, FLORIDA WEST AIRLINES

Mr. ATWOOD. Thank you very much, Mr. Chairman.

My name is Mark Atwood. I am with the law firm of Galland, Kharasch, Morse & Garfinkle here in Washington. We are Washington counsel for American Trans Air.

First, I would like to express regrets that Mr. George Mikelsons, who is the Chairman of American Trans Air, was unable to appear in person here today, as he was hoping to do.

We would like to commend you, Mr. Chairman, for scheduling this series of hearings on international aviation policy. We join in your concern that some of the policies that have been implemented by the Departments of State and Transportation have, in fact, contributed to greater industry concentration, greater market power in the hands of a few giant carriers, and ultimately less competition.

We've heard already today from a number of distinguished witnesses, academics and consultants, who have given the global picture of international aviation policy. What I would like to do today is to give the perspective of one particular carrier, a smaller carrier, but one that has been one of the real success stories of airline deregulation. I would like to focus particularly on two DOT poli-

cies. One is the carrier selection policy, and the other is a matter which we have already discussed quite a bit today, and that is route transfer policy.

American Trans Air believes the public would be substantially benefitted by increased participation in international markets by American Trans Air and other carriers like it. Unfortunately, we have to question whether we will ever get the chance to provide these kinds of benefits, given the current slant of international aviation policy.

ATA is based in Indianapolis. If I may, I'll just give you a little bit of background on the carrier. It was formed in 1973, and began operating public charters in 1981. Since that time, it has become the largest U.S. carrier primarily operating charter flights. In terms of its revenue passenger miles last year, it is the second largest of the so-called "national" carriers, and the thirteenth largest U.S. carrier overall. It currently operates a fleet of 23 jet aircraft, including twelve L-1011s and four 757s.

ATA has been extremely successful in the deregulated environment. It has compiled a financial record which at least in one respect is perhaps unequalled in the industry. That is, it has reported net and operating profits for 16 of the last 18 years. Last year was an exception, but whereas 1990 was an unmitigated disaster for most carriers, it was only marginally unprofitable for ATA.

ATA, however, would not like to be relegated to operating charters permanently. Therefore, in the last several years, it has begun to move cautiously into scheduled transportation markets. It currently operates scheduled domestic routes between Indianapolis and several points in Florida, as well as between San Francisco and points in Hawaii.

We have also begun to look at selected international scheduled routes. These includes route between Los Angeles and Copenhagen and Stockholm, as well as service between Los Angeles and Montego Bay, Jamaica, which we expect to start next month.

ATA would like to serve even more scheduled markets in the future. We are particularly interested in trans-Atlantic routes out of Philadelphia, which we would like to help to develop as an important international gateway. We have certainly met with a good deal of enthusiasm from Philadelphia officials about this. Philadelphia, we believe, has an enormous potential, but one which, unfortunately, is still very much untapped. For all of the financial difficulties which have been highly publicized about the City of Philadelphia, in fact, the Philadelphia Metropolitan Area is thriving, has a very strong business community, and has an airport which has undergone now a \$785 million capital improvement program. Notwithstanding all of this and despite excellent domestic transportation service, Philadelphia is still very seriously underserved by international flights.

In short, ATA sees a good many opportunities, at Philadelphia and elsewhere, for the kind of innovative service in new, undeveloped markets in which ATA is experienced in providing. We have been able to expand thus far by moving into markets which have unlimited entry. Many of the most valuable routes, unfortunately, are limited entry, because of the bilateral restrictions. Therefore, it is necessary to undergo a DOT carrier selection proceeding if one

wants to serve these routes. Thus, our enthusiasm for new service must be substantially tempered by the recognition that the DOT's carrier selection policies make it difficult, if not impossible, for a carrier like ATA to secure these valuable, contested routes.

The only venture that ATA has made thus far into these contested routes has been in the U.S.-U.S.S.R. North Atlantic route proceeding. In that case, we applied for a route between Philadelphia and Riga, Latvia, and Kiev by way of Shannon, Ireland. It would be the first U.S. carrier service to either of those Soviet points. After a lengthy hearing in December, the administrative law judge recommended that American Trans Air receive the route, and we're hoping any day now that the Department will concur in that recommendation. The reality of that particular case, though, is that United, Continental, and Delta withdrew their proposals, leaving only four contestants for three routes. We have to wonder, therefore, whether ATA would have been recommended for that route if the choice had been between ATA, on the one hand, and one of the mega-carriers proposing service from one of its fortress hubs.

We can hardly recall a single competitive route proceeding in recent years in which the award has not gone to an applicant with an enormous hub presence to back up its proposed international service. Probably the most important consideration in any of these route proceedings has been the power of the carrier at the hub.

In the halcyon days of deregulation under Professors Levine and Kahn, the CAB frequently granted routes to newer, innovative carriers like Air Florida, World, People's Express.

Now, however, DOT focuses disproportionately on choosing the carrier with the strongest route structure at the hub, and which believes that it is the most financially able to meet the foreign competition. However, by focusing almost myopically on which would be the strongest U.S. carrier to go against the foreign carriers, DOT is overlooking the benefits, in many cases, of fostering growth and new entry by smaller U.S. carriers that can inject innovation and enhance competition into some of these markets.

We realize that the Department faces a certain dilemma. Naturally, it wants to put the best foot forward in these markets. However, does an award to the largest and strongest carrier in each case always maximize U.S. benefits in the larger sense of the word? Is always selecting the safest bet or the mega-carrier that claims it's best able to compete with the foreigners, the wisest policy? Will that promote competition among U.S. carriers, or instead, simply become a self-fulfilling prophecy that the strong will always become stronger?

The Department still acknowledges that competition among U.S. carriers is the cornerstone of aviation policy. It appears sometimes, though, that the Department's mental image of competition is an exclusive playing field reserved only for the mega-carriers. This, I believe, is very different from the image of competition foreseen by Congress in the Airline Deregulation Act which, among other things, directed "the encouragement of entry into air transportation markets by new air carriers, the encouragement of entry into additional air transportation markets by existing air carriers, and the continued strengthening of small air carriers so as to assure a more effective, competitive airline industry."

Let me be clear that ATA is not advocating a complete reversal in current policy. We do not assert that global competitiveness is unimportant, or that such issues on an applicant's financial condition or strength at a gateway should be overlooked. We do, however, assert that the Department should seriously reassess its current policies and the degree of market concentration to which they are contributing. The pendulum has swung too far in one direction, and it should be made to swing back in the other direction to a more balanced position. Deliberate efforts should be made to include smaller or newer carriers, and to increase, rather than decrease, the number of airlines that participate in valuable international markets.

There has been a good deal of talk today about whether markets should be entirely open or whether the U.S., in some ways, is at fault in preserving limited entry markets. It is ATA's position that it would be a wonderful world if all markets, in fact, were unlimited entry. Unfortunately, that is not the case, and probably will not be so for some time.

There has been one recent case of which we are aware, in which DOT has made some effort to include new entrants. That is the 1990 Japan Gateways case, in which America West and Hawaiian were given route authority to Nagoya and Fukuoka. Rather than be too enthusiastic about it, however, I would have to note that those carriers received those routes only after American, Delta, and United got their choice of U.S.-Tokyo authority.

Even if the Department develops a more balanced approach to carrier selection cases, however, this progress would be for naught if routes continue to be subject only to private transfer among carriers like country club memberships or season tickets to the Redskins.

ATA is very concerned about this trend because we see more and more route opportunities being treated as private property, to be sold to the highest bidder. These are routes which ATA and carriers like it will never have even a theoretical chance to obtain in a competitive process. If routes are best allocated by sale to the highest bidder, as the Department apparently believes, then how is a carrier such as ATA ever going to have a fair shot at them? We'll certainly never be able to outbid American, United, or Delta.

The DOT claims that it approves only those route transfers which are in the public interest. However, this is inconsistent with another long-held premise of international aviation policy, and that is that in allocating limited route rights, the public interest requires that all interested carriers have an opportunity to compete for these routes, based on the quality of their proposal.

The Department has come a long way from this theory, however, as vividly demonstrated by its statement in the recent American-TWA route transfer case. I quote, "We believe that market forces can be effective in allocating the routes to an airline which is likely to provide appropriate service. * * * Accordingly, the airline which is willing to pay the highest price for purchase of a route, is likely to be an airline which will provide the maximum service in the market, in order to recover its investment."

Now, the people at ATA are firm believers in the efficacy of the marketplace to allocate goods and services. However, it is just sim-

plistic economics and bad policy to expect that limited route rights are going to be allocated in the most publicly beneficial way through privately negotiated inter-carrier agreement. I say it's bad economics because it ignores the fact that a cash-rich airline may be more interested in acquiring a route for the purpose of solidifying its market power at the gateway hub, the result of which is not necessarily pro-competitive. To the extent that a carrier purchases a route at a non-hub gateway, it may do so largely to foreclose entry by a competitor. Also, these arguments presume that all carriers have equal access to the capital markets to fund these acquisitions. Yet, in many cases, these carriers are able to fund acquisitions through borrowing on the basis of their routes, slots, and gates that were acquired, free of charge, from the public. So, a carrier's bid may, in fact, be more reflective of its ability to parlay its governmentally conferred assets into buying power, rather than the quality of the service that it expects to provide at the market.

As a number of witnesses and members of the subcommittee have said already today, these routes are governmentally created rights, and properly belong to the citizens of the United States. They are the result of intergovernmental negotiations intended to maximize air transportation benefits available to the public. They should be allocated according to pro-competitive policies as laid down by Congress in 1978.

There may be some cases in which an airline should be permitted to sell route authority, but these cases, I think, should be exception rather than the rule. These rights should be allocated in competitive proceedings, open to any carriers with a serious proposal, and not just passed from one carrier to another in private deals.

In closing, I would like to say a few words about some regulatory policies of the DOT and FAA which have rather profound competitive implications, and which are making things difficult for American Trans Air, even in its charter operations.

It seems that the mindset of the Federal regulators, particularly at the FAA, is so oriented toward the giant carriers that their regulations often overlook the very different needs and circumstances of smaller, and particularly charter, airlines. In our dealings with this agency, we have found sometimes a disturbing lack of familiarity with how charter airlines conduct their business. One example of that was a recent rulemaking to adopt a new part of the Federal Air Regulations, Part 119. The FAA said this proposal was simply to codify existing rules and policies. In fact, the proposed rule would actually transform many of ATA's charter operations into scheduled flights, if they meet a certain minimal level of frequency. This change would make many charter airline operations uncompetitive with charters operated by foreign carriers, or charter packages offered by the larger U.S. carriers. We believe that this ill-advised proposal arose out of the FAA's lack of familiarity with the way charter airlines operate.

Another example, which I would just touch on quickly is the very controversial proposal for the Passenger Facility Charge rules. The FAA proposed a means of carrier compensation, based on the float that airlines would be able to obtain during the short time that they held these funds. Unfortunately, unless a carrier is about the size of American Airlines and has 70 million passenger board-

ings a year, it would take sometimes many years, and in our case ten years, just to recoup the initial expenses of implementing this rule. We estimate that our start-up costs would be \$460,000, not to mention close to \$200,000 in annual recurring costs.

The final example that I would like to use is a topic which is of some sensitivity right now, particularly in this subcommittee, but it is one which we believe has very grave competitive implications. That is, the proposed rule to phase out Stage 2 aircraft. This, we believe, would have extremely grave consequences for many carriers that are not financially able to sustain the enormous cost burdens that this rule would impose. In fact, the FAA itself has admitted that the rule "will likely accelerate the demise of some carriers that are financially weak * * * [and] could severely weaken some carriers that are financially strong." These hardships, we believe, don't arise primarily from the legislative goals of an all Stage 3 fleet in 1999, as Congress has mandated, but rather from the way the FAA has proposed to implement that deadline.

ATA, fortunately, does not expect to be very seriously affected by this rule. Its fleet is already largely Stage 3, and it has an extremely high proportion of its RPMs conducted by Stage 3 aircraft. We have, however, joined with a coalition of a number of other air carriers and aircraft lessors to urge modification of this proposed rule. We are extremely concerned about the effect that this proposed rule would have on the overall condition and structure of the industry, and the degree of concentration that would result as the strong grow stronger, and the weak disappear.

As one other person involved in this coalition on behalf of his airline said, "We may be able to survive this rule, but we don't want to be the only mouse left running around the legs of the three or four elephants left standing."

These are only a few examples of rulemakings which have substantial but poorly understood competitive implications. The FAA and DOT must become more sensitive to the particular needs of smaller, charter, and new entrant airlines. Until then, however, these carriers will simply have to continue to wage a battle to make their interests known and avoid being pushed out of existence by regulations and policies that are tailored to fit the giant airlines.

Thank you, Mr. Chairman. That concludes my presentation.

Mr. OBERSTAR. Thank you very much. That was a very sweeping review and was very thoughtfully presented. I couldn't have put it better than you have on page eight with your description of routes and rights and to whom they belong.

Mr. Maloney, we look forward to your presentation.

Mr. MALONEY. Mr. Chairman and members of the subcommittee, my name is John Maloney. I am President and Chief Executive Officer of Florida West Airlines. I thank you for having me here today. With me is our Washington counsel, Herbert Rosenthal, who has submitted other comments on issues that concern me greatly. Because of their technical nature, I would appreciate your addressing your questions on these issues to Mr. Rosenthal. However, I wish to address an issue of most grave and urgent concern.

In addition to the written testimony which I am submitting for the record, I am submitting a binder with photographs and other documents and a video tape.

[The video tape is retained in the subcommittee files.]

Mr. MALONEY. I will explain these in a few minutes and would like them admitted into the record.

I became involved with Florida West in 1986 when I was asked to be an outside director.

My interests in the all-cargo business, especially its international aspects grew, and in September, 1989, I became President and CEO. Since that time, Florida West Airlines has grown into a \$60 million a year carrier, operating six Boeing 707-300 series freighters. We employ approximately 425 persons. Many are employed in our maintenance facility, which is an FAA licensed repair station for Boeing 707s, 727s, and 737s. In addition to performing our own maintenance, Florida West performs maintenance for other carriers, from turn around to the most extensive of scheduled maintenance, including airworthiness directives such as the FAA required aging aircraft programs.

Thus, we get to see first hand in our own facility, many aircraft which are maintained under Part 121 standards and those which are maintained without our FAA's stringent overview. As you know, the reason for our FAA's stringent overview is to maintain the highest possible level of airworthiness and safety—safety not only for the passengers and crews, but also for the massive population overflown by thousands of aircraft in our skies every day.

The American aviation industry has earned an extraordinary level of safety because of this FAA Part 121 overview, with its requirements of redundancy, not only in system design, but also in the checks and balances of multiple quality and safety checks. From the mechanic, to the inspector, to quality control, to operations control, to the flight crews and the FAA, there are checks and balances. Florida West Airlines believes in, and adheres to, this highest level of airworthiness and safety.

This is why we asked to speak to the subcommittee. We believe every aircraft allowed to enter our airspace must observe this same highest possible standard.

Last Fall we had the occasion to bring a foreign registered non-regulated aircraft into to our repair station. To protect against claims of damage to the aircraft, pictures and video tapes of the aircraft were made. We were absolutely horrified. There were hundreds of safety violations—violations of a magnitude to require grounding of the aircraft under Part 121 regulations. Any 121 operator flying this aircraft would risk, and I believe, should lose its license to operate.

The documentation provided to you (the pictures and the video tape) demonstrates the lack of airworthiness of this aircraft. It demonstrates also our affirmative action in notifying the FAA of this very dangerous situation, and our refusal to release the aircraft without a formal signed agreement by an agent of the foreign carrier operating the aircraft. This agreement required that the aircraft be inspected, repaired, made airworthy, and released by an FAA-approved repair station.

All of this and we failed. Magically healed, the aircraft flew away the very next day. We failed because you failed. Our Government has failed to close a giant loophole of the worst kind. It's the kind that allows unregulated, unsafe aircraft to over fly and put at random risk every American, every day. I believe the children in the school yard, the families in the subdivision, and the workers in the office buildings must be protected from a non-regulated aircraft flying through a loophole and destroying their lives.

The pictures, narrative, and video tape demonstrate the enormous and lethal potential of these non-regulated aircraft. I have provided each of the committee members with the video tape and binder of photos and documents. I wish to review the contents of the binder with you now.

If I could impose upon you to look with me at the photos that I've bound, very briefly. The cover sheet is a letter to file from our Quality Control Director just outlining the sequence of events as I've described them and the number and nature of the discrepancies found on the aircraft. It's interesting to note that when we notified our local FAA and the individuals that are named, they came over and inspected the aircraft. They agreed with us that the aircraft was not airworthy. They agreed with us that if they had jurisdiction, the aircraft would be grounded as being unsafe to fly.

The next page lists under the signature of a former FAA employee, using his experience as an ANP, agreeing with our findings so that we would have an impartial third party just reviewing these findings.

Rather than read the index of the shortfalls, I would rather go to the pictures later. I would point out to you that we were sufficiently concerned that we required that the operator of the aircraft sign an agreement with us before we would release the aircraft, whereby they agreed to bring it to another repair station for repair. As I've indicated, that didn't happen, because we failed. But, we tried very hard to make sure that we could keep that plane on the ground.

As you look at these pictures, you'll see a description, and as you perhaps know on aircraft, every part of the aircraft is called up very carefully, with various numerical descriptions of exactly where this part is. What is important when you look at these pictures is that you see in every case, shoddy workmanship, dangerous workmanship, or blatant attempts to cover up and hide a dangerous situation.

You see corrosion of the type that really started all of this aging aircraft's AD. The type of corrosion that took the top off the Aloha aircraft. You see speed tape, which is nothing more than highly adhesive aluminum tape, put over corrosion, put over de-lamination on controlled surfaces, covering up, in some cases, an entire access panel on the aft of the aircraft which, if it came lose, has the ability to take with it the controlled services if it hits the stabilizer.

You see cracks that are not only unrepaired, but also disguised. You see corrosion, which is exhibited by the rivets pulling through the aluminum skin. The reason for that is the corrosion between the skin joints expands and pulls the rivets through. You see speed tape patches on the control surfaces. There are no allowed tempo-

rary repairs to a controlled surface, for the obvious reason that it is so critical. There are literally hundreds of these on the aircraft.

Without belaboring the committee and asking them to look at this time at each and every picture, I think the point is made that the aircraft was certainly not maintained to a level that would be acceptable to our FAA, and not acceptable to a level that I think you would ride on the aircraft or would want your family to be on the aircraft, nor would you want your family to be in a populated area underneath the aircraft as it came into JFK, National, or Miami, or LAX.

One of these things that is particularly frightening is that you'll see—and it says it very dryly—rivets excessively loose on number 4 engine pylon. What that really means is, the engine was ready to fall off and could at any time—all 8,000 pounds of it. If it fell off on take-off, you might have had a 360,000 pound bomb. If it fell off after, you could have it drop on a population center, or you could cause the aircraft to drop on a population center.

The problem is that this is not, and I repeat, it is not an isolated example. If you walk out on a given day to any international airport, you'll see exactly the things that we are showing. So, what I'm saying is to please close the loophole. The best infrastructure for the maintenance of the highest level of airworthiness and safety in aviation already exists. It is our FAA and the "FAR Part 121" system of oversight and regulation.

If you extend the regulatory authority of our FAA to include any aircraft that enters our airspace, I think we would accomplish what we are trying to accomplish. There should not be a double standard for safety. Every aircraft allowed to enter our airspace should observe the same highest possible level of safety we impose upon ourselves.

I would reemphasize, please close the loophole.

One comment that I would make that was not in my testimony that I thought of as I listened to the other people here today is that they were talking about equal opportunity and reciprocity in opening markets. My thought is, the equal opportunity that we are offering to foreign carriers carries with it equal responsibility. I think that responsibility is to maintain their aircraft to the same level that we require ourselves to maintain ours.

I thank the subcommittee for having these hearings and allowing me to testify.

Mr. OBERSTAR. You have certainly provided graphic description with those photographs of the physical condition of the aircraft, which is lamentable, to be kind about it. That is a matter that requires FAA attention. This is an aircraft that you got from Chile, is that right?

Mr. MALONEY. Yes, but I perhaps failed to make my point which is that the FAA, which is our very capable policeman for monitoring our aircraft is impotent in this situation. They have no overview. They can not regulate this aircraft. They could not even ground it when they agreed it was not airworthy. It's a blind spot that we're letting aircraft into our airspace without even considering the same safety requirements that we impose upon ourselves—not just the aircraft, but the crews, and the training and the linguistic skills.

We had a situation in Miami two weeks ago where the President of Columbia was embarrassed because his jet was lost on the Miami airport, which is humorous, because no one was killed, but it easily could have been another accident like we had with the one aircraft on the runway being hit by another one trying to land.

The situation with Avianca 52 in Glenn Cove was a combination of a lack of linguistic skills and training, which is required by our FAA.

Mr. OBERSTAR. We're very familiar with that. We've had a hearing on that subject. The matter of maintenance, minimum equipment lists and heavy maintenance checks are matters that I've been very keenly concerned about and held hearings on previously when I chaired the Investigations and Oversight Subcommittee.

The question, also, of U.S. authority on the physical condition of foreign carriers entering our airspace is a matter that is a subject all of its own and one to which we need to devote further time; not within the scope of today's hearing, but it is not one that we're going to forget, either. This is a matter that I certainly shall take up with our Investigations and Oversight Subcommittee and we will jointly pursue this matter, I assure you. This is something of very, very grave concern. I appreciate your bringing that to our attention.

Mr. Atwood, if we were to project from here to the balance of this decade, with no change in DOT policies on route sales and slot sales and other international trade arrangements, what would be the role of a carrier like yours?

Mr. ATWOOD. It's difficult to say. As the industry becomes more and more concentrated, you have a small number of carriers that have increasing market power. It becomes more difficult to compete with carriers like that on an even footing. I think ATA will likely survive. They certainly have been successful thus far.

Of course, it's always difficult, particularly in this business to predict the future. I think that if ATA is to play a larger role, competitively speaking, in the air transportation industry, to the benefit of the American public, some policies will have to change. Either more routes will have to become open to more liberal or free entry, or DOT is going to have to, as suggested, make some changes in its carrier selection procedures.

At this point, there are some particular markets that ATA would like to serve and which we think we would do quite well at. However, we also, as their counsel, have to advise them that this is not worth the enormous expense of a formal route undertaking, or a carrier selection proceeding, because there just isn't any significant chance that they are going to get that route.

Because of that, I think, looking several years into the future, the American public will be somewhat the loser for that, because ATA and carriers like them could play a substantial role in bringing some more competition, particularly in new and undeveloped markets. I just don't see that happening to any significant degree without some change.

Mr. OBERSTAR. One of the reasons that those routes acquire value and then become more valuable over time is that our bilateral trade regime with, say, the British or the French limits the number of services, both ways. It limits the number of carriers that

can operate the routes that are permitted under the bilateral. So, because you then have a very precious commodity, because it is by international agreement limited, and its value goes up very high.

Now, if there were an open-ended trade regime in which the British could add as many sections and as many carriers as they wanted, and we could add as many carriers as chose to provide that service, those routes wouldn't have quite the same financial value in the marketplace.

Mr. ATWOOD. They would really only have the value of the facilities at the other end. Pan Am's route or TWA's route perhaps might still have some value because they have facilities at Heathrow, or because the British government, by their decision restrict who can come in and out of Heathrow. There is a value to serving that airport. But, other things being equal—no, those routes would have about as much value as a route to Belgium or The Netherlands—which is to say, anybody can have it for the asking.

Mr. OBERSTAR. So the only way, in the very highly contested markets that a new carrier can enter and be competitive is to buy what's available.

Mr. ATWOOD. But that simply isn't an option unless, of course, there is absolutely nobody else interested in it, and that is just not likely to happen if it's a meaningful market.

Mr. OBERSTAR. And the deep pockets will always be able to outbid those who are, as in your case, a new entrant.

Mr. ATWOOD. And the deep pockets, of course, are interested in keeping those as limited entry markets. Think of it, for a moment. Here in Congress, and most people in the industry are interested in pressing for more open entry into these markets. But if you were American, or Delta, or one of the other carriers that has one of these limited entry markets, what is there to be gained by you in pushing DOT to open this to anybody to come in? You have a valuable route, but it's valuable only so long as everybody else is foreclosed from coming into it.

Therefore, to the extent that DOT is largely driven by what the large carriers are pressing it to do, there is not really a great deal of incentive for them to change their policies to any extent.

Mr. OBERSTAR. You are one of the offspring of Mr. Kahn's grand scheme for the future and, in a sense, Mr. Maloney here, is as a carrier as well in the cargo field. Secretary Shane testified at our hearings earlier this year that the Department is very keen about getting entrants into service, including international service. The record seems to speak otherwise. The track record is not very, how should I say, encouraging for those in your position. What is your view? Is that just lip service to an ideal?

Mr. ATWOOD. I think that there are still some at the Department, and perhaps even Mr. Shane, that retain some degree of idealism in commitment to the notion of competition. I think perhaps they look at competition in a somewhat different way than we do. As I said, the exclusive playing field is reserved for the mega-carriers. I think that perhaps they are sincere that they would like to see some new carriers come in, but only in the no-risk situation. They are not willing to take a risk.

As I pointed out, the situation with America West and Hawaiian receiving their awards to Fukuoka and Nagoya. Those were only

after most of the other carriers had been satisfied. So, there is relatively little risk, particularly because U.S./Japan is already a very, very well developed market, and there are a lot of carriers to participate in that market. There was comparatively little cost for DOT to give an award, a few crumbs if you will, to the new entrants.

Perhaps in a route like Manchester, that would have been another opportunity—another opportunity where they might have done something, but now, I guess we'll never have that chance—in Philadelphia to London. You will recall that in the show cause order in the American/TWA route transfer, they suggested that they would spin-off Philadelphia and Baltimore/London and indicated that they would like to give those routes to a carrier that does not have a large, established U.S./London route presence already, or rather an East Coast/London route presence.

When we saw that, ATA was very enthused. We submitted a pleading to the Department saying, right on. Unfortunately, for other reasons which I will not quibble with, they decided against that in their ultimate decision. That is the kind of opportunity which we would like to see more of.

Mr. OBERSTAR. Mr. Maloney, do you have any observations along the same line?

Mr. MALONEY. I feel very aggressive about our ability to compete with any carrier, any place in the world. I have really only one desire. That is to see that whatever we have to do to operate our business, the other carriers must do. That's why I'm concerned that whatever level of safety that we have to adhere to, everybody else does, so that the costs are the same. I feel that we can compete any place. I don't need any help except a level field.

Mr. OBERSTAR. A level playing field—that's all we are, in fact, asking for.

In today's international aviation market, which is very highly regulated, subject to the provisions of an internationally negotiated agreement, and necessarily thereby restrictive, what does it matter to the consumer whether there should be any new entrants?

Mr. ATWOOD. It certainly has an effect on the pocketbook. Now, in some markets, of course, even if there is more liberal entry, there still may be restrictions on the price. Nonetheless, a new carrier coming in is going to take as much advantage as possible of whatever liberality there is built into the pricing regime in order to attract additional passengers. If ATA is given the U.S.S.R. route authority, you can expect that we will come in at substantially less than the fares being charged by the incumbents, or perhaps any of the other carriers that start service on a U.S./U.S.S.R. routing.

With the very fact of being a new entrant, we have to have something to entice the passengers. Therefore, to the extent that there is new entry, there are going to be more opportunities for passengers not only to ride on other carriers, perhaps with a different quality of service, but also to enjoy somewhat lower fares.

Mr. OBERSTAR. If there had been a bid procedure or a competitive process for transfer of routes—for example, in either the TWA or Pan Am case—that might have given a carrier like yours an opportunity it wouldn't otherwise have had. The Department had its first instance in the competitive process for establishment of a

route, but it lets the marketplace and the size of the pockets of various bidders determine the transfer of that route.

It seems to me that we ought to reinstitute a public policy process at the outset of the transfer as we do for the original award of a route, in which case a carrier like ATA would have at least a fighting chance to come up with the money to buy that route. This would be a matter for you to figure out, for the market to decide. If there is money to be made, certainly a way can be found to get the money to start off.

Mr. ATWOOD. Perhaps, although I think that we would find it difficult even in that instance, as long as there were some fairly deep pocket carriers who were interested in that route. I think something which would be much more acceptable from a public policy standpoint is to say, if a carrier is unable to serve a route for whatever reason, or no longer is interested in doing so, then that should revert back to the public, and should be opened up for competitive bids, not on the basis of price, but based on who can best serve that route, the way it is awarded when that route first becomes available under a bilateral.

Mr. OBERSTAR. That, I think, we could have very easily done had there never been a buy/sell process instituted in the first place. Then, those rights would always remain in the public domain and could be awarded on the basis of best service to the traveling public.

Mr. ATWOOD. Yes.

Mr. OBERSTAR. But, there are some inequities and complexities that have accrued with the history of buy/sell. We're trying to moderate this with this legislation, and we're trying to find middle groups here and to moderate and provide a niche for carriers like yours.

Mr. ATWOOD. I don't envy your position. It's a complex subject, and we recognize that.

Mr. OBERSTAR. Mr. Clinger.

Mr. CLINGER. Thank you very much.

Gentlemen, I'm sorry I wasn't here for your testimony. I just have a couple of questions.

Again, the Chairman made it clear that one of the reasons that I think we would have perhaps liked to have done what you suggest is because of the history of these things. They have been bought and sold for a long period of time. I think the Chairman earlier today said there could be a distinction, sometimes, in how a route has been awarded, but no development of that has ever taken place. There is no real investment. It's just sort of an asset without any investment in it.

In that instance, I think perhaps we could recognize that that should go back and be re-awarded without cost. But, where there has been an investment, and in some cases substantial in the route, even though it may become inactive, it's a little hard to say, that we're not going to do anything. You're not going to be able to realize anything from that route.

With regard to the route transfers and so forth, have you had a chance to review the bill that the Chairman put in with the support of some of the Canadians?

Mr. ATWOOD. I have reviewed the bill. I'm embarrassed to say that I've not reviewed it in the last couple of days with an eye toward the kind of question that I think is coming on. To anticipate what you may ask, I think that the bill is very good in principle, and I would certainly agree with its thrust. I'm not sure if it really goes far enough to help a carrier like American Trans Air, except perhaps in the instance where a route transfer would be disapproved under the more stringent criteria that the bill has proposed.

If that route transfer is disapproved, then I guess there still is a question of what will happen with that route. Will the carrier simply abandon it, or when it goes into bankruptcy, or ceases operations, or withdraws service on that route? Perhaps then it would become available in a competitive route proceeding or would be available through some other mechanism.

Mr. CLINGER. Yes.

Has your airline contemplated entry into the highly competitive U.S. market—in other words, attempting to compete in the market, and if not, why not?

Mr. ATWOOD. We are already competing, in fact, in a number of very competitive routes, more on a charter basis, and to some limited extent, on a scheduled basis; such as U.S./Scandinavia, which is fairly competitive. We believe that there is room for more carriers in that market, as well as a number of U.S./Caribbean routes, which are quite competitive, and ATA is holding its own there. As far as the more high profile route, such as U.S./UK, we are very interested, and I believe I mentioned this to the Chairman when you were out of the room. When DOT suggested in its initial decision—its initial show-cause order in the TWA/American route transfer case, that it was considering spinning off the Baltimore and Philadelphia/London routes, we were quite interested in that opportunity, because we are interested in developing more trans-Atlantic service at Philadelphia. Had that, in fact, gone through in the final decision, I believe that we would, in fact, have participated in that ensuing proceeding.

Mr. CLINGER. How about in the domestic market?

Mr. ATWOOD. On the schedule basis?

Mr. CLINGER. Yes.

Mr. ATWOOD. No, I don't believe that there are any extremely competitive routes, except perhaps San Francisco to Honolulu and Maui. Now, there certainly is a good deal of competition, including folks like United Airlines on those routes and, in fact, we have been able to hold our own there as well.

I don't think ATA is afraid of competition from anyone. Unfortunately, what we have to do is to seek out the niches. You have probably heard other carriers say that they try to find the niches. That's what ATA has to do. We obviously can't go in and compete head to head with United at Chicago, or American at Dallas/Ft. Worth. But, there are still a number of domestic and even some limited international routes in which there is not a carrier serving a particular community. As long as the niche is there, ATA can try to fit into that niche and serve what it sees as a public need.

Mr. CLINGER. There are some hurdles you have got to get over, though, aren't there, in terms of the advantages that they would

have in CRS, code-sharing, frequent flyer, and so forth that make it difficult for you to really compete on an even playing field?

Mr. Atwood. Absolutely. I think there has been some experience with routes to Florida where ATA developed some markets quite well and then USAir thought that they looked inviting and came in. Then, it was impossible for ATA to compete against them because of their frequent flyer program and their involvement in the CRS. We're hoping to take care of that problem through greater development as we move more into scheduled service. In the event, once a really giant carrier like USAir, American, or United wants to out-compete you at a hub in which they have considerable strength, I just don't know if there is any way that a smaller carrier can stand up to them.

Mr. CLINGER. Gentlemen, we thank you very much, both for your testimony and being patient in waiting so long.

The meeting is adjourned.

[Mr. Atwood's prepared statement appears on page 473.]

[Mr. Maloney's prepared statement appears on page 500.]

[Whereupon, at 3:50 p.m., the subcommittee adjourned, to reconvene at the call of the Chair.]

PREPARED STATEMENTS OF WITNESSES

STATEMENT
OF
AMERICAN TRANS AIR, INC.
BEFORE THE
SUBCOMMITTEE ON AVIATION
OF THE
HOUSE COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

HEARING ON INTERNATIONAL AVIATION POLICY

MAY 9, 1991

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STATEMENT OF AMERICAN TRANS AIR, INC.

American Trans Air appreciates this opportunity to testify before you today on a subject of great importance to the aviation industry, to the American public, and to this country's relations with the rest of the world.

First, we would like to commend you, Mr. Chairman, on scheduling this series of hearings on United States international aviation policy. We believe that at this time, an examination by Congress of the policies of the Departments of Transportation and State is seriously needed. American Trans Air joins in your concern that the policies these agencies have pursued have contributed to greater industry concentration, greater market power in the hands of a few giant carriers, and ultimately less competition. The losers are not simply certain airlines, but the American people.

We believe that the public would benefit by increased participation in international markets by American Trans Air and other carriers like it. We question, however, whether we will have the chance to provide these benefits, given the current biases of U.S. international aviation policy.

American Trans Air's history and record of success demonstrate its readiness for this increased role. ATA was established in 1973, and began operating public charters in 1981. Since that time, it has grown to be the largest U.S. airline primarily operating charter flights. Its revenue passenger miles are the second highest of any "National" airline, and the 13th highest of

any U.S. airline. ATA operates a fleet of 21 jet aircraft, including 10 L-1011s and four B-757s. Additional B-757s will be acquired next year.

ATA has been extremely successful in its operations. It has compiled a record of financial success which is perhaps unequalled among U.S. carriers: it has reported net and operating profits for 16 of the past 18 years. Last year -- which was an unmitigated disaster for most carriers -- was only marginally unprofitable for ATA.

Though ATA is still primarily a charter airline, it has in the past several years begun to move cautiously into the scheduled markets. It currently operates scheduled domestic routes between Indianapolis and Orlando, Fort Meyers, St. Petersburg, and West Palm Beach, Florida, and between San Francisco and Honolulu and Maui, Hawaii.

We have also begun to look at selected international scheduled routes. We were authorized in December 1990 and January 1991 to operate scheduled service between Los Angeles and Copenhagen and Stockholm. We will also begin scheduled service next month between Los Angeles and Montego Bay, Jamaica.

ATA wants to serve even more international scheduled markets in the future. We see this as a necessary step if we are to develop into a more competitively significant carrier. We are particularly interested in transatlantic routes from Philadelphia, which we would like to help develop as an important international gateway. We have met with enthusiastic support from Philadelphia

officials. Philadelphia has an enormous but largely untapped potential for international service. Its metropolitan area ranks fifth in the nation in terms of population and income, and its economic strength is growing at an above-average rate. Its airport serves the entire Tri-state area of Eastern Pennsylvania, Delaware and Southern New Jersey, and is undergoing a \$785 million improvement program. In spite of these qualities, Philadelphia is still seriously underserved by international flights.

In short, ATA sees many opportunities, at Philadelphia and elsewhere, for the kind of innovative service in new and undeveloped markets which we are experienced in providing. We have been able to expand thus far by moving into routes where there are no bilateral restrictions on entry. Many of the most valuable routes, however, are limited. Thus, it is necessary to go through a DOT carrier selection proceeding to obtain one of these valuable routes. Our enthusiasm for new service, therefore, is tempered substantially by the recognition that the DOT's carrier selection policies make it difficult, if not impossible, for a new entrant like ATA to secure valuable, contested international routes.

ATA's only venture thus far into a contested route proceeding has been in the U.S.-U.S.S.R. North Atlantic Combination Service case. After a lengthy oral hearing last December, the Administrative Law Judge in the case recommended that ATA be awarded its requested route from Philadelphia to Riga, Latvia, and Kiev, Ukraine, by way of Shannon, Ireland. This would represent the first U.S. carrier service to either of those points, and we

are awaiting the Department's decision, which is due later this month. We are hopeful that the Department will concur with the judge's recommendation. The reality is, however, that in that proceeding, United, Continental and Delta withdrew their proposals, leaving four contestants for three routes, one of which was a newly formed carrier. We must wonder, therefore, whether ATA would have been recommended if the choice were between ATA and one of the major carriers proposing service from one of its captive hubs. Despite the quality of ATA's proposal, its qualifications for the route, and the competitive benefits to Philadelphia and the public generally, DOT likely would have opted for one of the much larger carriers.

We can hardly recall a single competitive route proceeding in recent years in which the "power of the hub" to control traffic flows behind or beyond the hub has not been a critical issue, and where the award has not gone to an applicant with an enormous hub presence to back up its proposed international service. In the early days of deregulation, the CAB frequently granted routes to newer, innovative carriers like People Express, World and Air Florida. Now, DOT focuses disproportionately on choosing the carrier with the strongest route structure and the best financial condition to meet the foreign competition -- in other words, the safest bet. But by focusing primarily on competition of U.S. carriers against foreign carriers, DOT overlooks the benefits of fostering the growth of smaller U.S. carriers that can inject

innovation and enhanced competition into the air transportation system.

We recognize the dilemma the Department faces. DOT surely wants to put the best U.S. foot forward in any limited international market. Its natural tendency is to select the carrier with the biggest operation and the ability to self-connect the most traffic from the most points. Does an award to the largest and strongest carrier, however, "maximize" U.S. benefits in the larger sense of the word? Is always selecting the "safest bet," or the mega-carrier that claims it is best able to compete with a foreign flag carrier, the wisest policy? Will that promote competition among U.S. carriers, or, instead, result in a self-fulfilling prophecy that the strong will always get stronger?

The Department still acknowledges competition among carriers to be the very cornerstone of U.S. aviation policy. It appears, however, that the Department's image of competition is an exclusive playing field reserved for the mega-carriers. This is very different from the concept of competition envisioned in the Airline Deregulation Act of 1978 which, among other things, directed

[t]he encouragement of entry into air transportation markets by new air carriers, the encouragement of entry into additional air transportation markets by existing air carriers, and the continued strengthening of small air carriers so as to assure a more effective, competitive airline industry.

(Federal Aviation Act, section 102 (a)(10).)

ATA does not advocate a complete reversal of current policy. We do not assert that global competitiveness is unimportant, or that such issues as an applicant's financial condition or hub

strength at the gateway should not be factors in carrier selection. We do, however, assert that the Department must seriously reassess its current policies and the degree of concentrated market power which they are producing. The pendulum must be made to move in the other direction, and a more balanced position should be sought. Deliberate efforts should be made to include smaller or newer carriers, and to increase, rather than decrease, the number of airlines that participate in valuable international markets.

There has been at least one recent case in which an effort was made to include new entrants. In the 1990 U.S.-Japan Gateways Proceeding, DOT awarded authority to America West and Hawaiian to serve Nagoya and Fukuoka, respectively, largely on the ground that they were new entrants to the market. We must note, however, that America West and Hawaiian got these routes only after American, Delta and United got their requested routes to Tokyo, a far more valuable market. Thus, it is difficult to tell whether or not this case portends any real effort by DOT to open up opportunities for smaller carriers and new entrants.

Even if the Department develops more balanced carrier selection policies, however, this progress will be for naught if routes are subject only to private transfer among carriers, like country club memberships or football season tickets. We refer, of course, to the increasing use of route transfers to allocate international service rights.

ATA is concerned about this trend because it sees more and more route opportunities being treated as private property, to be

sold to the highest bidder. These are routes which ATA will never have even a theoretical chance to obtain in a competitive process. If routes are best allocated by sale to the highest bidder, as the Department apparently believes, how will a carrier such as ATA ever get a fair shot at them? It certainly never will be able to outbid American or United.

The DOT claims that it approves only those route transfers which are in the public interest. Yet this belief is inconsistent with another long-held policy premise, that in allocating limited route rights, the public interest requires that all interested carriers have an opportunity to compete for these routes based on the quality of their proposals. Thus, competing proposals can be weighed and evaluated, and, at least theoretically, the proposal with the greatest public benefits will be chosen.

How far the Department has come from that principle is vividly demonstrated by its statement in the final decision in the American-TWA route transfer case:

We believe that market forces can be effective in allocating the routes to an airline which is likely to provide appropriate service. * * * Accordingly, the airline which is willing to pay the highest price for purchase of a route, is likely to be an airline which will provide the maximum service in the market, in order to recover its investment.

(Order 91-4-47, at 17.)

We at American Trans Air are firm believers in the efficacy of the marketplace in allocating goods and services. However, it is simplistic economics, and bad policy, to expect that scarce and limited route rights can be allocated in the most publicly

beneficial way through privately negotiated inter-carrier agreements. It ignores the fact that a cash-rich airline may be more interested in acquiring a route for the purpose of solidifying its market power at the gateway hub, a result which is not necessarily pro-competitive. And, to the extent such a carrier purchases a route at a non-hub gateway, it may do so largely to foreclose entry by a competitor. Moreover, these arguments presume that all carriers have equal access to the capital markets to fund these acquisitions. Yet, it is abundantly clear that incumbent carriers are able to borrow money on the basis of slots, gates and international routes that were acquired free of charge, rather than on the basis of projected revenues from operations on the route. Thus, a carrier's bid may be more reflective of its ability to parlay its governmentally conferred assets into buying power, than of the quality of service its expects to provide on the route.

These routes are governmentally created rights, properly belonging to the American public. They are the result of intergovernmental negotiations intended to maximize air transportation opportunities available to the American public. It is, or should be, the function of the Department to allocate these rights in the way that will best serve that public. This should be done according to the pro-competitive policies laid down by Congress in 1978.

While there may be cases in which an airline should be permitted to sell route authority, these cases should be the exception rather than the rule. These rights should be allocated

in competitive proceedings open to any carrier with a serious proposal -- not passed from one carrier to the other in private deals.

Finally, we would like to add a word about how the regulatory policies of the DOT and FAA are making things difficult for us even in our present charter operations.

It seems that the mindset of the federal regulators, particularly at the FAA, is so oriented toward the giant carriers that their regulations often overlook the very different needs and circumstances of smaller, and particularly charter, airlines. In our dealings with this agency, we have found a disturbing lack of familiarity with how charter airlines conduct their business. One prime example of this was a recent proposed rulemaking to adopt a new section of the FARs, Part 119. The FAA said that this proposal is simply a codification of existing policies. However, the proposed rule would actually transform many of our charter flights into scheduled flights, if they operate over a very minimal level of frequency. This change would make many charter airline operations uncompetitive with charters operated by foreign carriers, or charter packages offered by scheduled airlines. We believe that this ill-advised proposal arose out of the FAA's lack of familiarity with the way charter airlines operate.

Another example is the recent controversial proposed rule on Passenger Facility Charges. The FAA proposed a means for carriers to recover their costs through the "float" on the PFC funds during the short time the carrier holds these funds. Unfortunately, the

FAA failed to recognize that not all carriers have 70 million enplanements per year, like American. Without such an enormous number of passengers, a carrier couldn't begin to recover the very steep costs of implementing a PFC accounting system. ATA estimates its first year costs at \$460,000. Under the FAA's proposal, it would take up to 10 years to recover this cost, not to mention the ongoing costs. Thus, only a few giant carriers would avoid losing money on this rule.

Finally, the proposed rule to phase out Stage 2 aircraft will have extremely grave consequences for many carriers that are not financially able to sustain the great cost burdens it will impose. In fact, the FAA itself has admitted that the rule "will likely accelerate the demise of some carriers that are financially-weak . . . [and] could severely weaken some carriers that are financially strong." These hardships do not arise primarily from the legislative requirement of a phaseout by the end of the decade, but from the way the FAA has proposed to implement that deadline.

ATA, fortunately, does not expect to be very seriously affected by this rule. Its fleet is already largely Stage 3 -- in fact, its proportion of revenue passenger miles operated by Stage 3 aircraft is among the highest in the country. Its fleet modernization program is already well under way. However, ATA has joined with a coalition of numerous other carriers and aircraft lessors to urge modification of this proposal. It is extremely concerned about the effect this rule would have on the overall

condition of the industry, and the degree of concentration that would result as the strong grow stronger, and the weak disappear.

These are only a few examples of recent rulemakings which have substantial but poorly understood competitive implications. The FAA and DOT must become more sensitive to the particular needs of smaller and charter airlines, new entrant airlines, and carriers in financial distress. Until then, however, these carriers will continue to have to wage a battle to make their interests known, and to avoid being pushed out of existence by regulations that are tailored to fit the giant airlines.

STATEMENT OF ALFRED E. KAHN^{*}
BEFORE THE
AVIATION SUBCOMMITTEE
OF THE
HOUSE COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

May 9, 1991

^{*} Robert Julius Thorne Professor of Political Economy, Emeritus, Cornell University; Special Consultant, National Economic Research Associates; Chairman, Civil Aeronautics Board, 1977-78.

I am grateful for this opportunity to participate in your deliberations about our international aviation policy and the future of international aviation. I testified before this Committee on the same subject almost 14 years ago, when I was Chairman of the Civil Aeronautics Board; those hearings eventuated in the International Aviation Policy Act of 1979, which in effect provided a welcome endorsement of the liberalization of international aviation policy that the Carter Administration had been promoting.

We at the Board—and, I am confident, Congress as well—regarded that evolving international policy as the logical complement of what we were trying to do domestically—to remove the comprehensive regulatory restraints on competition that had evolved over the preceding 40 years. What we proposed was to trade liberalizations for liberalizations—that is, to offer foreign governments and airlines ampler opportunities to compete for international traffic between their countries and ours in exchange for equivalent opportunities for American carriers. Specifically, I suggested in my testimony, we should, in our international negotiations, be seeking:

(1) the elimination of anti-competitive restrictions on charters and supplemental carriers...; (2) expanded opportunities for new low-fare scheduled service; (3) maximum access to markets by expansion...of nonstop U.S. gateways; (4) adequate multiple carrier designations; (5) avoidance of capacity or frequency restrictions; and (6) maximum flexibility for air carriers to operate to points beyond, or on the way to the country with whom the agreement is negotiated.²

In the then impending negotiations with Japan, for example, I pointed out:

We may find it to our advantage to offer the Japanese access to new U.S. points—not to give it to them in a niggardly spirit, but to say: come on in, we are prepared to offer you an opportunity to give additional service, additional competition to serve American markets—in return for removal of competitive restrictions on U.S. carriers....

That is the kind of bargaining that is good for consumers. They benefit from the concessions we give, and they benefit from the concessions we receive.³

We have not, since that time, come remotely close to reproducing in the international arena the thoroughgoing deregulation that we achieved domestically. Still, partly because of the negotiations sanctioned by the International Aviation Policy Act, partly because of the example set for the rest of the world by our domestic deregulation, and partly because of other such liberalizing

² Statement of the Civil Aeronautics Board on United States International Aviation Negotiations, Subcommittee on Aviation, House Public Works and Transportation Committee, September 29, 1977, p. 7.

³ *Ibid.*, pp. 13-14.

tendencies abroad as the prospective inauguration of the European Common Market, international aviation today is much more competitive than it was 15 years ago, and the trend continues.

The fruits of our domestic deregulation

I assume, from the subject the Committee has selected for these hearings, that you are not interested in yet another response to the question: has our deregulation of the domestic airline industry proved to be a success or failure? I will strenuously resist the temptation to offer my own answer, except as it bears on our future international policy: I am happy to accept Secretary Skinner's declaration that that debate is over and that deregulation has been a great success.

It is directly relevant to these hearings, however, that very few, even among the critics of deregulation, propose we reimpose the comprehensive, maniacally detailed restrictions on competition that regulation entailed. From this generalization I am compelled to except such stubborn critics as Hobart Rowen, of the Washington Post, who declares at one and the same time that airline travelers are now at the mercy of a few monopolists while decrying the disappearance of Eastern Airlines and the possible demise of several other carriers—which obviously threaten to occur only because competition in the industry is so intense. And who, pointing to the comparative absence of bankruptcies in Europe, asserts portentously: "that should tell us something"—apparently unconscious of what it does tell us, namely, that regulation can of course reduce the likelihood of airline bankruptcies by protecting companies from competition, but only at the cost of much higher fares.⁴

The fact remains that our domestic industry has become substantially more concentrated at the national level than it was before deregulation, that the trend continues, and that few of even the most ardent defenders of deregulation regard with complacency the possibility that the industry may shake down in the next very few years to only, perhaps, four major carriers (along, we pray, with Southwest!) and their scores of satellite feeders and affiliates. Moreover, while we see an industry still undeniably more competitive than it was permitted to be under regulation, and travelers still benefitting from that competition to the tune of many billions of dollars a year—with 91 percent of all passenger miles last year at discount fares, averaging 65 percent below full-coach—we see also very sharp increases in the unrestricted fares paid by the residual, comparatively small minority of non-discretionary travellers, and particularly ones beginning and ending their journeys at hubs dominated by a single carrier.

⁴ Last January, for example, Rowen complained about the \$142 one-way shuttle fare between New York and Washington—a journey of 214 miles. One wonders whether he preferred the comparable unrestricted fare of \$280 for the 207 miles between London and Paris, or the \$304 for the 287 mile Paris/Frankfurt flight. (These differences, I must point out, were inflated by the undervaluation of the dollar vis à vis the pound, franc and deutsche mark.)

There are three possible ways in which government might respond to this equivocal situation.

It could do nothing. We put up with a great deal of competitive imperfection in industries that we would not think of regulating. The airline industry is far more competitive than it was; the benefits of that competition have been widely distributed; and industry profits have been lower, on average, since deregulation than before: it is certainly not earning monopoly profits. In these circumstances, it would not be ridiculous to conclude that no remedy was required.

At the other extreme, it is not possible in principle to reject the reimposition of price ceilings to protect travelers subject to monopolistic exploitation, where restoration of more effective competition proves to be infeasible.

Third, the government clearly has neglected responsibilities of which it was never the intention of deregulation to relieve it. These include not only vigorous enforcement of the antitrust laws, but other policies designed to remove barriers to competition, such as expansion of airport capacity to keep open opportunities for competitive challenges to hub-dominating carriers, dissolution of preferential arrangements between those carriers and their hub airports, and, above all, lowering of the barriers to competition by foreign airlines, whether by direct entry or by investing in American carriers.

My own endorsement of the last approach and unwillingness to recommend the second—a position with which I am certain most economists would agree—is heavily influenced by a number of considerations. One is that it is by no means clear that the high unrestricted fares paid by the minority of passengers who cannot qualify for the discounted ones are not compensated for by frequent flyer credits and by the improved convenience of scheduling that those high fares and hubbing—the very hubbing that gives carriers the power to charge them high fares—help make possible. On the contrary, the principal component of the 15 billion dollar a year improvement in national welfare that Clifford Winston and Steven Morrison, of the Brookings Institution, attributed to deregulation (as of around 1985) was the improved convenience of scheduling available to business travelers: the place to live, if you want the most convenient service to the widest possible range of destinations, is at a hub. Moreover, so long as the trips in question are to another hub, dominated by another carrier, the traveler will ordinarily have at least two competitors among which to choose; and if it is to a destination reachable through another hub or hubs, there are likely to be several: according to my abbreviated Airline Guide, travelers between Boston and Phoenix have seven different carriers to choose from—and that includes the four who are almost certain to survive even if the present industry shakedown continues.

Moreover, as regulators have discovered over the ages, it is virtually impossible to regulate one single aspect of a transaction without regulating other aspects as well. Specifically,

it makes no sense to regulate price without regulating quality: price ceilings must be accompanied by floors under quality of service. It takes little imagination to see to what other regulations ceilings on airline fares might lead—prohibitions of reductions in the frequency of scheduling, in frequent flyer benefits, in the frequency with which full-fare paying customers are upgraded to first class and of deterioration in the quality of meals or increased charges for head sets, or longer lines at the ticket counter. These examples are not fanciful: all but one of them were adopted under regulation, in mirror image, to prevent competitive evasions of governmentally-set price floors.

In any event, it would be thoroughly irrational, because of the limited reemergence of monopoly, to contemplate going back to regulation as it was practiced between 1938 and 1978, which thoroughly suppressed all price competition.

The relevance of international aviation policy

The reconcentration of the American airline industry could conceivably have been prevented, or at least moderated, by more aggressive application of the antitrust laws, along with other competition-encouraging policies such as I have already mentioned. The industry might have developed differently had the Department of Transportation paid heed to the interventions of the Antitrust Division, as well as the concerns expressed by others of its critics, rather than complacently approved every single merger presented to it (in only one case requiring divestiture of directly competitive operations); or had the Department of Justice many years ago not refused to approve an industry proposal for a jointly-owned computerized reservations system; or had it moved more forcefully for divestiture of CRS systems; or tried in even a single instance to proceed against deeply discounted, discriminatory price reductions clearly aimed at low-cost, price-cutting carriers like People Express; or tested the theory that commission overrides to travel agents are like progressive quantity discounts offered as a reward for exclusive dealing, arguably prohibited by Section 3 of the Clayton Act.

We will never know whether a Piedmont, a Republic or a Western might have survived as effective competitors, had the Transportation Department not continued rapidly to assume airline markets were perfectly contestable, despite mounting evidence to the contrary, when confronted with their disappearances through mergers.

In any event, it seems to me the opportunity for that hypothesis to have been tested is clearly passed; and while I intend by that observation in no way to minimize the importance of intensified governmental efforts to preserve or encourage competition among carriers, we must confront the strong possibility that the principal source of competitive protection for consumers

henceforward, so far as the U.S. airline industry is to provide it, will be competition among a handful of existing megacarriers.

This means, I feel strongly, that while proceeding much more vigorously than before to attack barriers to genuinely new competitive entry into domestic markets by U.S. carriers, we must now, before it is too late, seek protection also in the proposition that eight or ten megacompetitors, worldwide, will almost certainly give travelers sufficient protection, provided they all have unrestricted access to the markets we're worried about. American consumers should not have slept well in the late 1970s, when they were served preponderantly by only three major U.S. automobile companies; but today eight or ten mega-manufacturers, operating worldwide, supply us with ample competitive protection.

The same principle applies to aviation.

I am of course aware of the political and legal obstacles to genuinely free trade in aviation services; but the opportunities are surely there, and when we become sufficiently concerned about concentration of our domestic industry, we must take advantage of them. The domestic American air travel market, from which foreign carriers are totally excluded, is an extremely tempting target for them: to the extent we could trade access to it for corresponding opportunities for our carriers abroad, the benefits to American carriers and their employees might well be sufficient to compensate for the increased competition to which they would be subjected—and of course there would be unequivocal benefits for American travelers.

An intermediate step, and one much more likely to be politically acceptable, would be to eliminate restrictions on foreign ownership or financial participation in American carriers, preferably, of course, on a reciprocal basis. Until the recent severe deterioration in their financial condition, under the combined influences of the Persian Gulf emergency and the slowdown in economic growth or recession, some foreign carriers were apparently actively interested in making such investments. KLM acquired a substantial interest in Northwest, SAS in Continental, Ansett in America West, and British Airways was for a time one of the parties proposing to participate financially in the reconstitution of United Airlines.

I opposed the last of those transactions on the antitrust ground that it joined together two of the most important competitors or potential competitors in world aviation. But there are all sorts of other such acquisitions that could salvage and strengthen failing American carriers and invigorate competition.

I suggested some two years ago that there were the makings of several possibly very good deals here, if we were to lift our restrictions. Foreign carriers were looking for American partners with whom to exchange traffic into and out of their international flights—feed they felt they required if they were to compete effectively on those routes with American carriers, which

have the advantage of extensive domestic route networks. Meanwhile, several American cities lacking direct international service were urging the Secretary of Transportation to let foreign airlines provide it. Among those cities were Kansas City and Orlando, both Braniff hubs. I surmised at the time that were it not for our restrictions a KLM—which had only shortly before the Braniff bankruptcy applied for the right to give those two cities their first non-stop transatlantic service—would have been delighted to acquire Braniff and keep it alive for its traffic feed, if it were then granted the right to fly between those hubs and Amsterdam. But that, it appeared, would be feasible only if it could funnel traffic to and from those cities through its Amsterdam hub on to or off one or another of the hundreds of international routes it flies beyond: there weren't enough people interested in flying only between Kansas City and Amsterdam to make the investment in Braniff worthwhile.

The Transportation Department at the time flatly refused to consider any such extension of service to third countries.

As I argued at the time:

We did not deregulate our airlines to shield them from competition, at home or abroad. We have to break the attitude that to permit foreigners to make investments here is somehow to do them a favor, which we should therefore not grant except when American companies seek and obtain comparable opportunities from their governments. On the contrary, where those investments expose American companies to intensified competition, the American public benefits at least as much as the recipients from what we 'give,' entirely apart from whether we seek or obtain similar favors from their governments.⁵

I am not in a position to assure anyone today that a TWA, Midway or a USAir could have its survival assured by a timely acquisition by a British, Singapore or Thai Airways, if those foreign carriers were free to acquire them, along with their domestic route systems. All I can say is that these restrictions on international investment—which could of course be conditioned by imposing or maintaining whatever national security requirements we choose upon the acquired American carriers—makes no sense whatever in an era of increasing concern about the sufficiency of competition to protect the American flying public. As my several illustrations suggest, I would of course have any such acquisitions subject to the same antitrust test as we should have been applying all this time to mergers of domestic companies—namely, they would be prohibited "where the effect may be to substantially lessen competition." Indeed, Congress might choose to go farther and permit them only "where the effect may be to preserve or enhance competition."

⁵ Letters to the Editor, The New York Times, November 15, 1989.

In either event, it is clearly time for Congress to set us on the road to completing the job it began with its Airline Deregulation Act of 1978 and its International Air Transportation Competition Act of 1979, in the latter of which it set forth as first among its goals:

In formulating United States international air transportation policy, the Congress intends that the Secretary of State, the Secretary of Transportation, and the Civil Aeronautics Board shall develop a negotiating policy which emphasizes the greatest degree of competition that is compatible with a well-functioning international air transportation system.⁸

⁸ Public Law 96-192, 96th Congress, Feb. 15, 1980, 94 STAT. 42, Sec. 17(b).

U.S. INTERNATIONAL AVIATION POLICY
AND BILATERAL AGREEMENTS

BEFORE THE U.S. HOUSE OF REPRESENTATIVE
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
SUBCOMMITTEE ON AVIATION

MAY 9, 1991

TESTIMONY OF MICHAEL E. LEVINE
DEAN, YALE SCHOOL OF ORGANIZATION AND MANAGEMENT

Mr. Chairman and members of the House Subcommittee on Aviation, I am pleased and honored to be invited here to present my views on what U.S. international aviation policy should be as we move into what will be an important and exciting decade. Please let me state for the record a few facts about my background:

I am Dean of the Yale School of Organization and Management and William S. Beinecke Professor of Management Studies at Yale University. I have been a scholar of air transport regulation since the early 1960's and have written numerous articles and made numerous presentations on airline competition and regulation and on international aviation policy. In the late 1970's, I served as General Director, International and Domestic Aviation at the Civil Aeronautics Board. In this capacity my responsibility included all substantive staff functions except consumer protection, including international negotiations, international routes and pricing, domestic routes and pricing, and all agreements between airlines, including international rate-setting and computer reservations systems. After leaving the CAB, I served as Executive Vice President, Marketing for Continental Airlines, in charge of market planning, marketing and all customer service functions, and then served as President and CEO of New York Air, a new entrant airline, which moved from large losses to profits during my term as CEO. I have served and continue to serve as a consultant and expert witness for a number of U.S. and foreign airlines, but I appear today solely as an independent invited committee witness. No airline has reviewed my testimony or is compensating me in any way for presenting my views today.

I said at the opening of my testimony that we are entering an important and exciting decade in international aviation. The last decade might have been important as well, but U.S. aviation policy seemed almost designed to make sure it wasn't exciting. U.S. policy embarked on a very promising course in the late 1970's and 1980. In this brief period, unprecedented numbers of markets were opened to U.S. carriers and their foreign counterparts, producing the greatest expansion of U.S. international operations in aviation history and introducing foreign travel to unprecedented numbers of ordinary American citizens.

Despite this promising start, U.S. policy lost momentum almost from the beginning of the decade. The supposedly procompetitive Reagan administration pursued, with apparent Congressional consent, a narrow-minded, timid and short-sighted policy. This policy, labelled "balance of benefits", apparently was adopted in response to those who saw the extraordinary growth and dynamism of the previous several years as threatening. Attacks on the previous market-opening measures took the form of criticism that the U.S. was being too open-handed by offering generous access to the U.S. market in exchange for firmly guaranteed U.S. access to markets abroad. These critics apparently saw international aviation as a pie which had to be sliced and distributed to airlines with exquisite precision. So focussed did we become on exchanging perfectly equal slices that we ceased to notice that each new piece we exchanged was getting smaller and smaller. In the process cities, regions, airports and the travelling public were losing important opportunities. Equally bad, U.S. airlines were losing opportunities to fashion new international service patterns which complemented the domestic restructuring they were undertaking in response to deregulation.

Ironically, the avowedly free-trade, procompetitive administration of the 80's managed to take American international aviation policy full circle back to the mercantilist and interventionist mid-70's. The CAB, State Department and Department of Transportation had worked together in reaction to the cramped and constricted "bargain" of Bermuda 2 to fashion expansive, dynamic, forward-looking policies. These policies provided both U.S. carriers and the traveling public with unprecedented opportunities. By the end of the decade, they had been scrapped in favor of Bermuda "2 and a half" and a series of other half-hearted measures which accommodated foreign needs while mainly preserving the U.S. *status quo*.

It is especially ironic that the balance of benefits policy which emerged in response to criticism of the open-handedness of its expansionist predecessor produced, like its counterparts of the 1970's, agreements (Bermuda 2 and Bermuda 2 and a half) which were the most

imbalanced against U.S. airlines in the history of U.S. international aviation. Bermuda 2 substituted limited designations, capacity controls and reduced fifth freedom rights for what had been a relatively open Bermuda 1 agreement. Bermuda "2 and one half" substituted two strong U.S. carriers for two others once strong but now weakened in return for a promise to allocate virtually all future growth, at least for the next several years and possibly for far longer, in the UK-US market to British airlines. This agreement in effect paid the British for the fact that British Airways and the independent British airline sector had become stronger, while Pan Am and TWA had weakened. In the process, it deprived the U.S. industry of further opportunities and some portion of the U.S. public of the benefits of international competition.

How did this happen? What are the challenges and opportunities now facing U.S. aviation policymakers? What policies should the U.S. pursue to best position U.S. policy for the 1990's?

To make sensible policy for the future, we need to understand the past. In general outline, the underlying causes of the past decade's international aviation policy weaknesses are pretty simple. In the late 1970's, after the debacle of Bermuda 2, U.S. aviation policymakers figured out some basic facts:

- 1) U.S. airlines as a group could be very effective competitors in world markets. This didn't mean that every U.S. airline would dominate every market in which it competed with a foreign carrier, but that on the whole U.S. carriers could survive and even prosper against foreign competition.
- 2) As long as this was generally true, one didn't have to answer the question, "for whom is U.S. aviation policy made -- the travelling public or the U.S. industry?". On the whole, both would benefit from a procompetitive aviation policy. Even though individual airlines might suffer, the government didn't owe them a living at the expense of the general public.
- 3) The fact that some foreign carriers could benefit substantially from open markets was both tactically and strategically important. It was tactically important because it meant that there were partners available with whom market-opening agreements could be made, and once those agreements were made, others would have to follow to avoid being left behind. It was strategically important because the U.S. could not possibly pursue a policy that benefitted only U.S. airlines. Our trading partners had no incentive to agree to such arrangements and we couldn't defend them. The policy was credible as a matter of international relations and defensible from a political standpoint, both for the U.S. government and for other governments, because it created the certainty of benefits for both the U.S. and foreign traveling publics and left open the possibility that both foreign airlines and our own might reap benefits and bear costs. No one could state with certainty that the game was rigged either in our favor or in favor of others. We created instead a relatively level playing field and let the public benefit from the ensuing contest.

This policy produced and was embodied in agreements with Belgium, Germany, The Netherlands, Korea, Taiwan, Singapore, Israel, Jamaica and others. The regime they created was free and competitive to the point of being astonishing to veteran observers of the aviation scene. Aviation markets opened wide, producing remarkable growth and substantial benefits for those airlines, U.S. and foreign, that were adaptable enough to take advantage of them. Countries which wished to see trade and tourist traffic grow and countries willing to allow their airlines to face competition were willing to join with us in moving world trade forward. Perhaps even more important, countries which were unwilling to sign such agreements with us were obliged to adopt policies which opened their own markets, so as to preserve the competitiveness of their own gateways and airlines.

No truly competitive process can guarantee that everyone is a winner, but many U.S. airlines did very well in the newly opened markets and growth in those markets has exceeded growth in most markets that remained closed. In many of those markets, U.S. share actually

increased, but this varied from market to market, as one would expect in a genuinely open regime. Airlines and their employees which had difficulty adapting to open markets complained, although regional officials and the public rejoiced. Airlines that did well took the policy for granted. As criticism from the losers mounted, the winners were seduced by the hope that they could keep or even enhance the gains they had made while somehow "pulling up the ladder" and preventing other airlines from pursuing the same opportunities. "They're giving away the store" was the rallying cry, and the government locked the doors instead, opening them only to one customer at a time, and then only on the strictest of terms.

Not surprisingly, fewer "customers" were able to make deals with us, and the market-opening process lost momentum. Rather than continue to move ahead bilaterally with those who were willing to trade freely, the U.S. began to support multilateral discussions which could be blocked or slowed by those who most opposed freer trade in aviation. We were never sure whether to heed civic and consumer interests who wanted more service and more competition, or to listen to those who were afraid of open competition. We wanted "fair" competition in which we always won. This option, not surprisingly, was unavailable. It takes two to make a trade, and no one knowingly makes a trade in which all the benefits go to the other side.

We stopped counting public benefits and counted only predictable gains to our airlines. In doing so, we dismissed as worthless the value of the opportunity to compete, and in so doing lost, not gained, bargaining leverage. Before, we could go to another country and say "We're willing to take our chances. Our airlines win some and lose some and both our publics benefit. You should do the same, and if you don't want to, we'll find someone near you who does." This was a game in which the size and value of the U.S. market gave us enormous credibility and in which our willingness to take a chance of opening it presented the other side with tempting opportunities.

We gave up this approach in the name of *realpolitik*, and ironically we lost leverage. Worse, it turned out that we Americans weren't as good at horsetrading of microadvantages as were countries which had been doing it among themselves for decades! We ended up with the worst of both worlds -- parsimonious deals which got us few public benefits, but in which we got commercially snookered over and over again. We could occasionally bully a small country which badly needed market access, and we would allow ourselves occasionally to do an even swap in a small way, but time after time -- with the Italians, the Spanish, the Germans, the French, the British and the Japanese -- we played the intricate game of benefits trading and we lost.

I suppose I should acknowledge here that on occasion, we showed a certain generosity to some smaller countries whose goodwill we needed on other counts. But we consistently turned down imaginative market-opening deals when proposed and we consistently frittered away opportunities to make bold proposals of our own, for fear of being criticized as too generous.

Yet another irony in this irony-filled process was that, as we became "tougher" and more constricted in our bargaining approach, we became less able credibly to consider tough countermeasures when we were in fact being taken advantage of under existing agreements. There is always another side to every international story, and when we attempted to preserve or extend existing imbalances instead of providing new opportunity, foreign publics were very ready to believe that we were throwing our weight around. This enabled foreign governments which were in fact keeping their publics from traveling and their tourist industries from growing to be seen as protecting national honor instead.

During the period when we were being openhanded and offering large opportunities to others, our apparent generosity made credible the possibility that we would feel free morally and politically to take retaliatory action against those who were keeping our carriers from doing business or who were threatening to restrict further our existing market-access rights. Those restricting us could not accuse us of wanting from them anything we weren't offering ourselves, or of asking them to take risks that we weren't willing to accept. And when they continued to

pursue restrictive policies, they often had their own publics to answer to, once it became clear that the U.S. was offering the possibility of expanded travel and lower fares in exchange for market access by our own carriers.

By contrast, in the "balance of benefits" regime, every foreign government could claim to be threatened by Goliath. Our size and prosperity have always made us vulnerable to Yankee-bashing, and it was a lot easier to be "the Japan (or Germany, or the UK) that could say no" to a U.S. offering trades for narrow advantage than to a U.S. willing to offer open opportunity in return for a similar opportunity abroad.

What are the opportunities that justify reconsidering our policies? First and foremost, this is an extraordinary period in modern history. Markets, relationships, even economic systems are being reexamined and replaced. Western Europe is moving, however erratically, toward a single market, and a single overarching political jurisdiction, seen as totally visionary a decade ago, now seems at least conceivable. We have a free trade agreement with a Canada which is struggling to reinvent its own political future. We are considering, however reluctantly, a similar agreement with a Mexico which is in the middle of profound change. Our relationship with Japan is in near-crisis, as we vacillate between insisting on a level playing field and on demanding that the fences, the baselines and sometimes even the scoreboard be biased in favor of the home team. Australia and New Zealand, hitherto protectionist in the extreme, have made profound revisions in both their domestic regulatory policies and their external trade policies. I set aside as not relevant for aviation in the near term the momentous events in Eastern Europe and the Soviet Union, but they clearly will warrant serious attention at some point in the future.

What should we do to seize these opportunities? The U.S. should be bold and firm, generous and tough. We need to be able to insist on open markets to continue to manufacture opportunities for our traveling public, our cities and regions and our airlines. We need to be bold in offering access to our markets, in order to make sure that our negotiating partners have incentives to deal with us and are under domestic political pressure to do so. We need to be tough in insisting that we get what we have already bargained for in doing business rights or in market access. We should be willing to terminate a bilateral agreement which is totally unacceptable to us and does not offer the prospect of progress, as long as our counteroffer is generous enough to obviate the charge of bullying. The United Kingdom terminated Bermuda I, but we have been unable to persuade the British that the Bermuda 2 which resulted (and which they highly prize) has been at risk in any negotiation since 1980.

How will our own interests respond if we pursue the sort of policy that I am recommending here? It is human nature to want a good chance at what the other person has without being willing to risk what is already ours. Our cities want more open agreements, but are often unwilling to see tough bargaining tactics put existing service at risk. Our airlines are for opportunities in markets they don't serve and for protection where they already have adequate access. Our labor unions are frightened of foreign competition, as is labor in all advanced countries, and like those other labor forces wants at the same time job opportunities in expanding companies.

We should be sympathetic and try to soften adverse impacts, but we should forge ahead. As long as we are opening new markets for all, we can resist understandable but parochial local and regional pressures. As long as airlines are getting access to new markets, it should be possible to insist that they accept negative impacts on those that they already have. As long as we have immigration laws and labor laws, airline labor need not fear competition on its home turf. Whether or not such competition has some foreign management or ownership, most jobs will be performed by Americans, just as they are in transplant auto industries. And we are a lot better when compared with others at running airlines than we are at making cars.

By now, you are all probably thinking, "this man is hopelessly idealistic!" But consider the results of the "practical" policies of the last decade and compare them with the results of the

"idealistic" policies of the previous three years. Do not merely compare the growth both of market size and of total U.S. participation in markets with 1978-81 bilaterals compared to those with less open regimes (even though that comparison largely favors open regimes), but also consider what the performance of those markets which remained restricted would have been if there had been no open markets with which they had to compete. I believe that you will conclude that the combination of an open hand and a willingness to act against abuse is a much more practical policy than the green-eyeshades bookkeeping in which we have been engaged for the past decade.

What we discovered thirteen years ago is still true: U.S. airlines as a group can be very effective competitors in world markets. Since this remains true, we can continue to pursue a procompetitive policy in the belief that it will benefit both the traveling public and the U.S. industry as a whole. And we still can make progress by offering strategic aviation partners opportunities that will make protectionism difficult to justify to their domestic constituencies and that will allow us to be insistent without appearing to be selfish or bullying.

We must act now to participate in and influence the enormous changes taking place in the environment affecting international aviation. We must attempt to create an open North Atlantic - North American aviation environment, being simultaneously willing to discuss a grand agreement and vigorously pursuing market-opening measures on a bilateral basis. This means being willing to proceed generously and boldly with those willing to open markets now, while firmly refusing to be as generous to those who take advantage of that generosity to relieve pressures for more open competition.

Separately, we should move as rapidly as we can to establish a single aviation market in North America, first offering the Canadians with whom we already have a free trade agreement an opportunity to extend that agreement to air services. This would mean giving the Canadian airlines the right to create U.S. hubs to remedy the disadvantage at which their geographic location puts them vis-a-vis the centrally-located hubs of American carriers. Of course, any such opportunity should be fully reciprocal. As our trade relations progress with the Mexicans, we should be willing to offer them the same arrangement.

These two measures will be mutually reinforcing. The prospect of being left out of a North Atlantic agreement will influence the Canadians. The prospect of being left out of a North American market will influence the Mexicans. The ability to offer access to all of North America in return for access to all of the European Community will facilitate agreement, and the ability (if that is how the timing works out) to offer a single important European state improved or open access to all of North America should enhance the possibility of making progress with the EEC.

The logic of generosity linked with firmness in pursuing open markets suggests answers to some much-discussed questions which currently face us. For example, there has been much interest in the question of how much foreign ownership should be allowed in U.S. carriers. We should permit 100 per cent ownership of U.S. airlines by nationals of states or regions with which we have totally open agreements, should restrict more closely than at present ownership of U.S. carriers by nationals of states who insist on using nationality as the prime goal of airline competition, and should have in-between rules for those in between. In the same way, cabotage ought to be available to those willing to enter what amounts to a single aviation market with us, but we should be very firm in confining its benefits only to those who are willing to open markets completely. And we should recognize that strategic considerations may influence with whom we are willing to move first in these matters. (I might add that national security or labor market considerations should be addressed directly, rather than indirectly through trade restrictions, when we consider these issues.)

In short, we should use the lessons of the past to face the challenges of the future. We have already experimented, however unwittingly, with both dynamic and static approaches to

international aviation agreements. We have seen that a dynamic and vigorous approach works best, and that such an approach actually allows us to be firmer in protecting the rights of our carriers to do business abroad and access other markets. We have seen that the seemingly cautious and pragmatic approach of the past ten years has disadvantaged our cities, the traveling public and our airlines, and produced agreements "balanced" against us to boot! Air transport is a industry in which the U.S. can lead the world while the world gains benefits at the same time. Isn't that a deal we should embrace?

BEFORE THE
SUBCOMMITTEE ON AVIATION
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
HOUSE OF REPRESENTATIVES

STATEMENT OF JOHN J. MALONEY, PRESIDENT OF FLORIDA WEST AIRLINES

JOHN J. MALONEY
PRESIDENT
FLORIDA WEST AIRLINES
P.O. BOX 523970
MIAMI, FL 33152
PHONE: 305-871-4700

MAY 9, 1991

Mr. Chairman and members of the Subcommittee: my name is John J. Maloney, I am President and Chief Executive Officer of Florida West Airlines. I am pleased to be here. With me today is the company's Washington counsel, Herbert A. Rosenthal, who has submitted other comments on issues that concern me greatly. Because of their technical nature, please address your questions on these issues to Mr. Rosenthal. However, I wish to address an issue of most grave and urgent concern.

In addition to the written testimony which I am submitting for the record, I am submitting a binder with photographs and other documents and a video tape. I will explain these in a few minutes and would like them admitted into the record.

I became involved with Florida West in 1986 when I was asked to be an outside director.

My interest in the all-cargo business -- especially its international aspects grew, and in September, 1989, I became President and CEO. Since that time Florida West Airlines has grown into a \$60,000,000 a year carrier, operating 6 B-707-300 series freighters. We employ approximately 425 persons. Many are employed in our maintenance facility, which is an FAA licensed repair station for B-707, 727 & 737 aircraft. In addition to performing our own maintenance, Florida West performs maintenance for other carriers, from turn around to the most extensive of scheduled maintenance, including airworthiness directives such as the FAA required aging aircraft programs.

Thus, we get to see first hand -- in our own facility -- many aircraft which are maintained under Part 121 standards and those which are maintained without our FAA's stringent overview.

As you know, the reason for our FAA's stringent overview is to maintain the highest possible level of airworthiness and safety -- safety not only for the passengers and crews, but also for the massive population overflowed by the thousands of aircraft in our skies every day.

The American aviation industry has earned an extraordinary level of safety because of this FAA "Part 121" overview, with its requirements of redundancy, not only in system design, but also in the checks and balances of multiple quality and safety checks. From the mechanic, to the inspector, to quality control, to operations control, to the flight crews and the FAA -- there are checks and balances. Florida West Airlines believes in, and adheres to, this highest level of airworthiness and safety.

This is why we asked to speak to the Subcommittee. We believe every aircraft allowed to enter our airspace must observe this same highest possible standard.

Last fall we had the occasion to bring a foreign registered non-regulated aircraft into our repair station. To protect against claims of damage to the aircraft, pictures and video tapes of the aircraft were made. We were absolutely horrified -- there were hundreds of safety violations -- violations of a magnitude to require grounding of the aircraft under Part 121 regulations. Any 121

operator flying this aircraft would risk and, I believe, should lose its license to operate.

The documentation provided to you (the pictures and the video tape) demonstrates the lack of airworthiness of this aircraft.¹ It demonstrates also our affirmative action in notifying the FAA of this very dangerous situation, and our refusal to release the aircraft without a formal signed agreement by an agent of the foreign carrier operating the aircraft. This agreement required that the aircraft be inspected, repaired, made airworthy and released by an FAA approved repair station.

All of this and we failed! Magically healed, the aircraft flew away the very next day! We failed because you failed. Our government has failed to close a giant loop hole of the worst kind. The kind that allows unregulated unsafe aircraft to over fly and put at random risk every American every day. The children in the school yard, the families in the subdivision, and the workers in the office buildings must be protected from a non-regulated aircraft flying through a loop hole and destroying their lives.

The pictures, narrative, and video tape demonstrate the enormous and lethal potential of these non-regulated aircraft. I have provided the committee members several copies of the video tape and binder of photos and documents. I wish to review the contents of the binder with you now.

¹ Attached to this document are copies of documents and an extract of the narrative comments of Florida West's General Manager who made the video tape.

Please close the loop hole. The best infrastructure for the maintenance of the highest level of airworthiness and safety in aviation already exists; it is our FAA and the "FAR Part 121" system of oversight and regulation.

Extend the regulatory authority of our FAA to include any aircraft that enters our airspace. There should not be a double standard for safety. Every aircraft allowed to enter our airspace should observe the same highest possible levels of safety we impose upon ourselves.

PLEASE CLOSE THE LOOP HOLE!

I thank the Subcommittee for holding these hearings and allowing me to testify.

testimony.jjm

APPENDIX TO TESTIMONY OF JOHN MALONEY
EXCERPTS FROM THE NARRATIVE OF VIDEO TAPE TAKEN OF
LAN CHILE B-707 (REGISTRATION CC-CEB) IN MIAMI

The aircraft was in Florida West's facility in Miami, Florida for routine maintenance. During this inspection of the exterior, the inspection revealed that there were numerous speed tape patches over many surfaces of the aircraft.

Many of these speed tape patches were on control surfaces which is illegal.

The inspection revealed numerous instances of cracks and corrosion of critical parts. Many parts were held together solely with speed tape. Several plates were held on solely by high speed tape. There were instances where corrosion had caused the rivets bonding skins together to fall out.

A main fuselage joint in the forward part of the fuselage was severely corroded. There were many instances of loose rivets and loose fasteners throughout the aircraft. There were many instances of corrosion in the skin laps.

At least two of the thrust reversers were corroded and leaking and had evidence of soot buildup.

Certain plates were taped onto the aircraft rather than secured by the appropriate fasteners or bonding. If any of those plates were to come off in flight, the aerodynamic characteristics of the aircraft could change and give the flight crew a difficult time.

Control surfaces such as rudders and airlerons and elevators must be finely balanced within tolerances. When a carrier makes

repairs by applying speed tape rather than making a repair in accordance with the manufacturer's instructions, these control surfaces could be out of balance and the aircraft might not perform as the flight manual predicts.

The videotape was taken by Florida West's Vice President and General Manager, John R. Petersen. It is his voice on the tape.

c:\fwa\appendix.tes

Florida West Airlines

P.O. BOX 523970, MIAMI, FLORIDA 33152, TELEX 52-2830 FLA WEST - MIA

TELEPHONE: (305) 871-4700
FAX: (305) 871-8144

September 28, 1990

To: File

Re: Lan Chile - CC-CEB

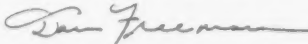
On Wednesday September 26, 1990 independent consultant Mr. Jamie D. Serra Sr. A&P IA 1051606 inspected the aircraft CC-CEB and concurred with items listed (1 thru 33) by Florida West Airlines Inspectors.

Florida West Airlines P.M.I. Mr. Franklin notified the international office of Mr. Vic Tamaris 7500-65. Mr. Tamaris came to Florida West Hanger (1500 hours) and conferred with Mr. Serra & Mr. Dan Freeman, Director of Quality Control, Florida West Airlines. After inspecting the aircraft, CC-CEB, with the finding that the aircraft appeared to be unairworthy and should not be dispatched until thoroughly inspected and necessary repairs be made prior to departure (Mr. Tamaris stated that if the aircraft were 'N' reg., he would have to ground the aircraft. But would have to advise the Chilean Authorities of the condition and findings on CC-CEB instead.)

A letter was drafted and a list of the obvious external discrepancies was sent to Mr. Charlie Fedderwitz FSDO 19 Miami, Florida also a letter of release and acceptance of aircraft CC-CEB together with an agreement to have the aircraft inspected and released by certified FAA Repair Stations prior to departure from Miami International Airport was signed and notarized by Lan Chile representatives in the presence of the attorneys for both Lan Chile and Florida West Airlines. Aircraft was removed from Florida West Hanger.

Mr. Victor Tamaris advised Dan Freeman, 10:30 am, on September 28, 1990, that Chilean Aviation Authorities had been notified and responded by Fax that they intended to come to Miami to discuss the problem and quality of work being performed by Lan Chile further update to follow.

12:45 hours September 28, 1990



Dan Freeman Dir. Of Q.C.

c.c. J. Maloney
J. Serra
O. Martin

9-26-90

FEDERAL AVIATION ADMINISTRATION
 FSDO-19
 PO BOX 592015
 MIAMI, FL 33159

ATTENTION: CHARLIE FEDDERWITZ

RE: LAN CHILE B707-300C REGISTRATION CC-CEB

CC-CEB

1. PRODUCTION BREAK STA 360 FROM S-20R TO S-28R, HEAVY CORROSION GROUND OUT AND FILLED IN WITH ~~APPOXY~~ ^{EPOXY}.
2. SKIN CORROSION AT STA 540 BETWEEN S-23R/S26R.
3. FWD BAGGAGE "C-1" DOOR SKIN CORRODED.
4. NON FLUSH PATCH AT STA 520/540 S-22R WITH ONLY ONE ROW OF RIVETS.
5. NON FLUSH PATCH AT STA 400 S-25-S-26R.
6. RIVETS SUCKED IN AT S-27R FROM STA 400-480.
7. S/M REPAIR ON AFT FRAME OF C-1 DOOR CORRODED.
8. 2 SPEED TAPE PATCHES BETWEEN STA 600-600D AT S-24/25.
9. SPEED TAPE PATCH AT STA 600H-600J S-24/25R.
10. SKIN CORROSION JUST FWD OF GROUND START AIR RECEPTACLE.
11. L/H PACK AIR INLET AIR SCOOP JUST FWD LOOSE FASTNERS.
12. ACCESS PLATE # 1185 INSTALLED WITH SPEED TAPE. (STABILIZER COMPT ACCESS PLATE).
13. ACCESS PLATE #1188 INSTALLED WITH SPEED TAPE. (TAIL CONE COMPT ACCESS PLATE).
14. WING ROOT TO FUSELAGE WRAP AROUND PANEL #1157 CRACKED.
15. CORROSION AND RIVETS PULLING TROUGH AT PRODUCTION BREAK STA 360 S-25-S28L.
16. EVIDENCE OF EPOXY REPAIR AT STA 520/580 S-26/27L.
17. RIVETS SUCKED IN STA ST 580/600 S-27L.
18. RIVETS SUCKED IN STA 600F-600G AND FROM 600J-600K S-27L.

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FAA
CC-CEB
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19. L.W. FILLET FLAP T/E IMPROPER REPAIR.
20. L.W. I/B FLAP NUMEROUS IMPROPER PATCHES AT T/E AND HONEYCOMB AREA.
21. L.W. I/B AILERON HAS SPEED TAPE REPAIRS.
22. L.W. O/B FLAP HAS NUMEROUS IMPROPER REPAIRS.
23. L.W. O/B AILERON HAS NUMEROUS IMPROPER REPAIRS.
24. L.W. O/B T/E IMPROPER REPAIRS.
25. L.W. REAR SPAR REPAIR FWD OF FUEL DUMP SHUTE CORRODED FASTNERS.
26. R.W. FILLET FLAP IMPROPER REPAIRS.
27. R.W. I/B FLAP NUMEROUS IMPROPER HIGH SPEED TAPE REPAIRS.
28. R.T. WING I/B AILERON AND TAB IMPROPER REPAIRS.
29. R.T. O/B FLAP NUMEROUS IMPROPER REPAIRS.
30. R.T. O/B AILERON IMPROPER REPAIRS.
31. R.T. WING O/B SECTION BOTTOM SURFACE IMPROPER PATCH AND NUMEROUS CHERRY RIVETS.
32. HILOCK RIVETS PROTUDING FROM FUEL TANK AT FRONT SPAR WITH DIMPLED WASHERS UNDERNEATH - 1 AT O/B OF #2 L.E. FLAP AND 1 AT MIDDLE OF #9 L.E. SLAT.
33. RIVETS WORKING LOOSE O/B #4 ENG PYLON "EXCESSIVE".

I HAVE INSPECTED, REVIEWED AND CONCUR ON UNAIRWORTHINESS DISCREPANCIES AND CONSIDER AIRCRAFT UNSAFE FOR FLIGHT.


JAMIE L. SERR
A&P 1A 1051606
(813) 988-8307

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- 34. #2 Engine Reverser O/B forward. Improper repair, loose rivet's and corrosion.
- 35. Alt Engine Reverser I/B forward. Improper repair, loose and missing rivet's and corrosion.
- 36. #1 Engine Reverser O/B Forward section. improper repair and corrosion.
- 37. #1 Engine Reverser I/B Forward section has corrosion.
- 38. Production Break STA 820 S-8/S-9R. Above second window aft of rear emergency exit right side, has corrosion.
- 39. Production break STA 820 S-9/S-10L. Above second window aft of rear emergency exit left side, has corrosion.
- 40. Corrosion at STA 720/740 S-9/S-10R. Above middle window, between emergency exits on top, upper L.H. aft panel.
- 41. Corrosion at STA 720/740 S10L upper L.H. aft panel between emergency exits on top.
- 42. Corrosion at production break STA 600K S-3/S-5L, L.H. side of crown.
- 43. Left vertical stabilizer and rear fuselage has hydraulic leaks and corrosion.
- 44. Left stabilizer to body fairing has corrosion.
- 45. Main cargo door hinge corroded.
- 46. Strut to wing wrap around panels, fastener's held in place with speed tape.
- 47. Right wing I/B flap upper surface corrosion and speed tape.
- 48. No emergency red mark at window and handle-cockpit are, exterior R.H. side.
- 49. Pitot static tubes improperly painted No paint allowed inside circle.

BEFORE THE
SUBCOMMITTEE ON AVIATION
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
HOUSE OF REPRESENTATIVES

ADDITIONAL STATEMENT OF FLORIDA WEST AIRLINES

Herbert A. Rosenthal
Herbert A. Rosenthal, Chartered
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MAY 9, 1991

ADDITIONAL STATEMENT OF FLORIDA WEST AIRLINES

I. FLORIDA WEST'S REQUESTS FOR CHANGES IN U.S. INTERNATIONAL AVIATION POLICY.

Florida West sees a great future in international aviation all-cargo services. Florida West believes there should be changes in U.S. international aviation policy in two major respects:

1. As Mr. Maloney addresses in his statement, the FAA should be allowed to ground or exclude from U.S. airspace aircraft which are so poorly maintained that, were they of U.S. registry, an FAA inspector would not have to think twice about grounding it; and
2. The Department of Transportation should not be so generous in giving Fifth Freedom charter rights to foreign carriers because the playing field is not level and because there are not realistic fifth freedom opportunities for U.S. carriers in many countries.

II. THE FAA SHOULD BE PERMITTED TO GROUND FOREIGN OPERATED OPERATED AND REGISTERED AIRCRAFT THAT DO NOT ACHIEVE BASIS LEVELS OF AIRWORTHINESS.

Florida West recognizes that under the Chicago Convention and ICAO Annex 6, a signatory country's carrier can fly its aircraft -- almost regardless of quality of maintenance or condition of the aircraft -- into U.S. airspace even if that aircraft would be instantly grounded by the FAA were it registered there. Theoretically, all aircraft should be maintained in a safe and airworthy condition as the minimum worldwide standard. But, as Mr. Maloney's statement documents, some foreign aircraft are not airworthy -- however that term is defined.

There are many aircraft operated by countries whose maintenance standards in practice are clearly not adequate to assure the safety of the travelling and shipping public and those whose homes, offices, schools, etc. are in the departure and approach paths to our nation's major airports. Should a poorly maintained aircraft of foreign registry crash in a populated area because of a mechanical problem, Florida West is afraid that the public outcry will be to ground any aircraft that is more than 20 years old. Florida West and the smaller U.S. carriers which generally fly older aircraft would bear the brunt of the public outcry for improved air safety even though U.S. carriers' fleets are operated under FAR Part 121 which is a much higher operating and maintenance standard than adhered to in practice by carriers of many less developed countries. Yet, under the Chicago Convention, U.S. carriers are the only ones which the FAA can easily regulate, so a massive public outcry for protection will be visited first on U.S. carriers whose aircraft are probably maintained and operated to a higher safety standard than those of many foreign carriers.

Why does the United States government allow foreign carriers to operate clearly unairworthy aircraft when they could endanger innocent American citizens on the ground or American citizen passengers? Has the time come to change that policy and to amend the Chicago Convention or the Federal Aviation Act so that the FAA can ground aircraft that are without the slightest doubt unairworthy? Florida West thinks the answer is "Yes".

So many foreign carriers seek to serve the United States because it is a rich source of passenger and cargo traffic. While the imposition of Part 121 standards on some foreign carriers might exclude them from access to the United States, how does that justify the added risk to passengers and people on the ground? Florida West believes that Congress should re-visit this question. We recognize that it is not a politically simple task.

III. BECAUSE OF THE CHICAGO CONVENTION, FOREIGN CARRIERS
HAVE A SIGNIFICANT OPERATING COST ADVANTAGE OVER
U.S. CARRIERS.

Florida West seeks to compete on a level playing field. In the Western Hemisphere markets, price rather than quality or reliability determines which carrier a shipper will use. For \$10 per hour differential, a shipper will switch from a U.S. carrier to a foreign carrier. One of the reasons why the foreign carrier can often charge less is that much less money is spent on maintenance, crew training (initial and recurrent), flight crews (both because of salary differentials and because flight and duty time requirements are less onerous), and other matters. For the most part, the cost differentials in these categories are purely the result of U.S. carriers having to comply with FAR Part 121 whereas airlines from many countries have only minimal safety and maintenance standards with which to comply. Thus, they can underbid U.S. carriers consistently because they spend less on maintenance. Florida West gets particularly incensed when these same carriers receive carte

blanche access to Fifth Freedom markets to and from the United States.

If the playing field were level and all carriers serving the United States had to adhere to Part 121 standards, then U.S. carriers would not be disadvantaged competitively and persons living or working near airports would have risks reduced of being in the wrong place at the wrong time.

IV. THERE ARE SIGNIFICANT DIFFERENTIALS IN LANDING FEES
BETWEEN THE UNITED STATES AND FOREIGN COUNTRIES.

Another area where Florida West would like a change in aviation policy is in the landing and handling fees imposed on U.S. carriers in foreign countries. At Miami, Florida West pays a few hundred dollars per landing to the airport. When Florida West lands in many foreign countries, it pays thousands of dollars in landing fees. These fees are on top of the exit or entry taxes most Western Hemisphere countries impose on passengers. Obviously these fees subsidize some other aspect of that country's aviation structure (including subsidies to government owned carriers) or economy as a whole. We would like the Departments of State and Transportation to inquire into the economic justification for these high fees. If these fees subsidize the flag carriers or other activities beyond the airport, then our government should persuade these countries to reduce their landing fees and collect the taxes needed from other, local sources.

V. THE U.S GOVERNMENT SHOULD TAKE STRONGER ACTION AGAINST
FOREIGN GOVERNMENTS THAT DISCRIMINATE AGAINST SMALLER
UNITED STATES CARRIERS.

While Florida West appreciates the efforts of the Department of State and Department of Transportation in obtaining improved cargo opportunities for U.S. carriers and taking action to end discriminatory practices, smaller countries do violate their bilateral agreements without sanction. The case in point is Barbados. Under the United States--Barbados agreement, the United States can designate multiple U.S. passenger and cargo carriers to serve the United States-Barbados-and beyond markets. The United States has done so for Florida West.

Even though Florida West has been designated by the Department of State under that bilateral, the government of Barbados has steadfastly refused to allow Florida West to operate scheduled all-cargo service, on a fifth freedom basis, to Barbados. On March 6, 1990, Florida West filed a complaint at the Department of Transportation against Caricargo (Barbados' cargo carrier) and BWIA under the International Air Transportation Fair Competitive Practices Act of 1974. (DOT Docket 46829) The Department issued Order 90-3-18 and Order 90-4-18 (April 12, 1990) requiring Caricargo to file its charter schedules on a weekly basis because the government of Barbados refused to honor the agreement.

On June 5, 1990, Florida West formally asked the Department to increase the sanctions. The Department took no action. After a semi-fruitful bilateral session in July 1990, the bilateral talks scheduled for early October 1990 were cancelled because of the

uncertainty over the U.S. federal budget. Barbados cancelled the session scheduled for January 1991. On January 25, 1991, Florida West again formally asked the Department of Transportation to increase the sanctions against Caricargo because it continued to violate the bilateral. The Department has yet to issue an order in response to either motion.

Negotiation sessions have been scheduled and then cancelled by the governments of both sides. Yet, Barbados continues to deny Florida West (and at least one other U.S. carrier -- Amerijet) what is due U.S. carriers under the bilateral. As a result, Florida West has not been able to operate to Barbados. Yet Caricargo continues to fly 3 to 5 trips per week from its de facto base in Miami (that is another story for another subcommittee) and has the entire all-cargo market to itself -- all because its government sniggers at the United States and does not honor the agreement, and the United States government does nothing to compel compliance.

Florida West has asked the United States to put Caricargo on a prior approval regime to help get the message across. The Department will not. It may be that to do so might jeopardize (even for an instant) the operations of politically more powerful scheduled passenger carriers; those carriers do not want even the slightest risk of being subjected to a foreign country's retaliation. We shed American blood and economic coin to rid Kuwait of Saddam Hussein. Yet this very same government will not sanction the carrier of a country which will not honor its bilateral agreement with the United States.

An order requiring Caricargo to obtain advance approval of its schedules would probably result in the problem being solved in a day or two. When American Airlines was designated to served Costa Rica under the bilateral and Costa Rica balked, the United States pulled out all the stops. While we recognize that American Airlines has far greater political might than does Florida West, we do not understand why the Department of Transportation and the Department of State tolerate countries' thumbing their noses at the United States.

VI. THE DEPARTMENT OF TRANSPORTATION SHOULD BE REQUIRED TO RE-THINK ITS LIBERAL POLICY OF GRANTING FIFTH FREEDOM FLIGHT APPROVALS TO COUNTRIES WHICH HAVE NO REALISTIC FIFTH FREEDOM OPPORTUNITIES FOR U.S. CARRIERS.

Florida West's last concern is with the Department of Transportation's liberal fifth freedom approval policy. It is unrealistically liberal. When the Department knows that a foreign country will not as a policy matter grant fifth freedom opportunities to U.S. carriers, the Department will generally not grant fifth freedom charter rights to carriers from those countries.

But even though a country may have a nominal policy allowing United States' carriers to run fifth freedom flights, there may not be any economic opportunities extant for such operations. And a foreign country's ostensibly open fifth freedom policy may not in practice be so generous. The economies of many countries do not lend themselves to such opportunities for U.S. carriers. For example, Egypt does not nominally forbid U.S. carriers from operating fifth freedoms. Yet there are hardly any fifth freedom

opportunities for U.S. carriers into or out of Egypt. But Egyptian cargo carriers can freely look for flights to or from the United States and obtain approval of its fifth freedom application over Florida West and other carriers' objections.

Florida West's basic markets are third and fourth freedom markets. Because the United States is such a major exporter and importer, foreign carriers line up to haul cargo anywhere they can. Because many of these carriers have operating costs lower than U.S. carriers for the reasons mentioned at the beginning of this statement and because the Department will rarely disapprove a fifth freedom request, a large part of our potential market is pirated by fifth freedom operators.

Florida West would like to encourage a change in U.S. aviation policy. Fifth freedom operations (unless bargained for in a bilateral agreement) should not be freely granted unless the applicant can demonstrate that there are real fifth freedom opportunities available in its home country for U.S. carriers.¹ There must be equality of opportunities. Otherwise, carriers must content themselves with third and fourth freedom flights.

The Department of Transportation does not appear to be willing to change this policy. While there are lofty policy advantages

¹ There are several Dominican Republic carriers. While they do operate between the Dominican Republic and Miami, they also operate many fifth freedom charters. There are very few fifth freedom opportunities for U.S. carriers from the Dominican Republic. Indeed, that country has denied Trans-Air-Link (a U.S. DC-6 operator) a license to operate third and fourth freedom charters. The Department of Transportation does nothing to sanction carriers of the Dominican Republic as a result.

which support it, in reality business in U.S. third and fourth freedom markets is being taken away from the third and fourth freedom carriers. As the rebuilding of the Persian Gulf commences, the Department should think long and hard about whether carriers of every country should serve this market. There is ample competition among U.S. carriers; if there is a demonstrable lack of capacity, then a fifth freedom operator may be justified in obtaining some authority.

Florida West thanks the subcommittee for considering its views.

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Florida West Airlines

P.O. BOX 529070, MIAMI, FLORIDA 33152, TELEX 53-2630 FLA WEST - MA

TELEPHONE: (305) 871-4700
FAX: (305) 871-8144

September 28, 1990

To: File

Re: Lan Chile - CC-CEB

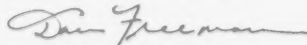
On Wednesday September 26, 1990 independent consultant Mr. Jamie D. Serra Sr. A&P IA 1051606 inspected the aircraft CC-CEB and concurred with items listed (1 thru 33) by Florida West Airlines Inspectors.

Florida West Airlines P.M.I. Mr. Franklin notified the international office of Mr. Vic Tamaris 7500-65. Mr. Tamaris came to Florida West Hanger (1500 hours) and conferred with Mr. Serra & Mr. Dan Freeman, Director of Quality Control, Florida West Airlines. After inspecting the aircraft, CC-CEB, with the finding that the aircraft appeared to be unairworthy and should not be dispatched until thoroughly inspected and necessary repairs be made prior to departure (Mr. Tamaris stated that if the aircraft were 'N' reg., he would have to ground the aircraft. But would have to advise the Chilean Authorities of the condition and findings on CC-CEB instead.)

A letter was drafted and a list of the obvious external discrepancies was sent to Mr. Charlie Fedderwitz FSDO 19 Miami, Florida also a letter of release and acceptance of aircraft CC-CEB together with an agreement to have the aircraft inspected and released by certified FAA Repair Stations prior to departure from Miami International Airport was signed and notarized by Lan Chile representatives in the presence of the attorneys for both Lan Chile and Florida West Airlines. Aircraft was removed from Florida West Hanger.

Mr. Victor Tamaris advised Dan Freeman, 10:30 am, on September 28, 1990, that Chilean Aviation Authorities had been notified and responded by Fax that they intended to come to Miami to discuss the problem and quality of work being performed by Lan Chile further update to follow.

12:45 hours September 28, 1990



Dan Freeman Dir. Of Q.C.

c.c. J. Maloney
J. Serra
O. Martin

9-26-90

FEDERAL AVIATION ADMINISTRATION
 FSDO-19
 PO BOX 592015
 MIAMI, FL 33159

ATTENTION: CHARLIE FEDDERWITZ

RE: LAN CHILE B707-300C REGISTRATION CC-CEB

CC-CEB

1. PRODUCTION BREAK STA 360 FROM S-20R TO S-28R, HEAVY CORROSION GROUND OUT AND FILLED IN WITH ~~APPOXY~~⁶.
2. SKIN CORROSION AT STA 540 BETWEEN S-23R/S26R.
3. FWD BAGGAGE 'C-1' DOOR SKIN CORRODED.
4. NON FLUSH PATCH AT STA 520/540 S-22R WITH ONLY ONE ROW OF RIVETS.
5. NON FLUSH PATCH AT STA 400 S-25-S-26R.
6. RIVETS SUCKED IN AT S-27R FROM STA 400-480.
7. S/M REPAIR ON AFT FRAME OF C-1 DOOR CORRODED.
8. 2 SPEED TAPE PATCHES BETWEEN STA 600-600D AT S-24/25.
9. SPEED TAPE PATCH AT STA 600H-600J S-24/25R.
10. SKIN CORROSION JUST FWD OF GROUND START AIR RECEPTACLE.
11. L/H PACK AIR INLET AIR SCOOP JUST FWD LOOSE FASTNERS.
12. ACCESS PLATE # 1185 INSTALLED WITH SPEED TAPE. (STABELIZER COMPT ACCESS PLATE).
13. ACCESS PLATE #1188 INSTALLED WITH SPEED TAPE. (TAIL CONE COMPT ACCESS PLATE).
14. WING ROOT TO FUSELAGE WRAP AROUND PANEL #1157 CRACKED.
15. CORROSION AND RIVETS PULLING TROUGH AT PRODUCTION BREAK STA 360 S-25-S28L.
16. EVIDENCE OF EPOXY REPAIR AT STA 520/580 S-26/27L.
17. RIVETS SUCKED IN STA ~~580~~⁵⁷/600 S-27L.
18. RIVETS SUCKED IN STA 600F-600G AND FROM 600J-600K S-27L.

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FAA
CC-CEB
PAGE 2

19. L.W. FILLET FLAP T/E IMPROPER REPAIR.
20. L.W. I/B FLAP NUMEROUS IMPROPER PATCHES AT T/E AND HONEYCOMB AREA.
21. L.W. I/B AILERON HAS SPEED TAPE REPAIRS.
22. L.W. O/B FLAP HAS NUMEROUS IMPROPER REPAIRS.
23. L.W. O/B AILERON HAS NUMEROUS IMPROPER REPAIRS.
24. L.W. O/B T/E IMPROPER REPAIRS.
25. L.W. REAR SPAR REPAIR FWD OF FUEL DUMP SHUTE CORRODED FASTNERS.
26. R.W. FILLET FLAP IMPROPER REPAIRS.
27. R.W. I/B FLAP NUMEROUS IMPROPER HIGH SPEED TAPE REPAIRS.
28. R.T. WING I/B AILERON AND TAB IMPROPER REPAIRS.
29. R.T. O/B FLAP NUMEROUS IMPROPER REPAIRS.
30. R.T. O/B AILERON IMPROPER REPAIRS.
31. R.T. WING O/B SECTION BOTTOM SURFACE IMPROPER PATCH AND NUMEROUS CHERRY RIVETS.
32. HILOCK RIVETS PROTRUDING FROM FUEL TANK AT FRONT SPAR WITH DIMPLED WASHERS UNDERNEATH - 1 AT O/B OF #2 L.E. FLAP AND 1 AT MIDDLE OF #9 L.E. SLAT.
33. RIVETS WORKING LOOSE O/B #4 ENG PYLON "EXCESSIVE".

I HAVE INSPECTED, REVIEWED AND CONCUR ON UNAIRWORTHINESS DISCREPANCIES AND CONSIDER AIRCRAFT UNSAFE FOR FLIGHT.


JAMIE L. SERRA
A&P IA 1051608
(813) 988-8307

9-25-90
FAA
CC-CEB
Page 3

34. #2 Engine Reverser O/B forward. Improper repair, loose rivet's and corrosion.
35. Aft Engine Reverser flB forward. Improper repair, loose and missing rivet's and corrosion.
36. #1 Engine Reverser O/B Forward section. Improper repair and corrosion.
37. #1 Engine Reverser flB Forward section has corrosion.
38. Production Break STA 820 S-8/S-9R. Above second window aft of rear emergency exit right side, has corrosion.
39. Production break STA 820 S-9/S-10L. Above second window aft of rear emergency exit left side, has corrosion.
40. Corrosion at STA 720/740 S-9/S-10R. Above middle window, between emergency exits on top, upper L.H. aft panel.
41. Corrosion at STA 720/740 S10L upper L.H. aft panel between emergency exits on top.
42. Corrosion at production break STA 600K S-3/S-5L, L.H. side of crown.
43. Left vertical stabilizer and rear fuselage has hydraulic leaks and corrosion.
44. Left stabilizer to body fairing has corrosion.
45. Main cargo door hinge corroded.
46. Strut to wing wrap around panels, fastener's held in place with speed tape.
47. Right wing flB flap upper surface corrosion and speed tape.
48. No emergency red mark at window and handle-cockpit are, exterior R.H. side.
49. Pitot static tubes improperly painted No paint allowed inside circle.

LIMITED RELEASE

KNOW ALL MEN BY THESE PRESENTS: That LINEA AEREA NACIONAL-CHILE, S.A., ("LAN CHILE") for good and valuable consideration, the receipt whereof is hereby acknowledged,

HEREBY releases, acquits, satisfies, remises, and forever discharges FLORIDA WEST GATEWAY, INC., d/b/a FLORIDA WEST AIRLINES ("FLORIDA WEST") from all manner of action and actions, cause and causes of action, suits, debts, dues, sums of money, accounts, reckonings, bonds, bills, specialties, covenants, contracts, controversies, agreements, promises, guarantees, variances, trespasses, damages, judgments, executions, claims and demands whatsoever, in law or equity, which LAN CHILE, now has, or which any of its successors or assigns, hereafter can, shall or may have, against FLORIDA WEST, said release being limited as follows: for, arising from or on account of any liability that may arise as a result of FLORIDA WEST'S act of retaining possession of a Boeing 707 Aircraft, Registration #CC-CEB (the "Aircraft"), which is owned by LAN CHILE, for the period from September 21, 1990 until the date hereof. This release is specifically limited as set forth above and is not a release of any other claim, except that LAN CHILE agrees to accept the Aircraft in an as is, where is condition.

IN WITNESS WHEREOF, the undersigned has hereunto set his hand and seal this 27 day of SEPTEMBER, 1990.

Signed, sealed and delivered
in the presence of:

LINEA AEREA NACIONAL-CHILE, S.A.

By: _____

STATE OF FLORIDA)
COUNTY OF DADE)

SEAL
NOT

WITNESS my hand and official seal in the county and state last mentioned on this 27 day of September, 1990.

[Signature]
NOTARY PUBLIC

My Commission Expires:

880-0881

September 27, 1990

LAN CHILE takes the aircraft without Florida West's warranty as to airworthiness and warrants to Florida West that it will not fly the Aircraft out of Miami without first delivering the Aircraft to an FAA approved repair station and receiving the Aircraft for flying in accordance with law.

Lan Chile states that the Aircraft contained no cargo while in the possession of Florida West from September 21, 1990, until the date of this letter.

Lan Chile states that it owns the Aircraft and that there are no lessees having any interest in the Aircraft.

This letter is given as an inducement to Florida West to accept the Limited Release dated this 27th day of September, 1990, from Lan Chile.

Lan Chile

By

Julio Cesar Larnefranke

Florida West

By

John J. Maloney

ITEM #1: PRODUCTION BREAK STA 360 FROM S-20R TO S-28R

This is a critical joint that has suffered heavy corrosion. The corrosion was ground out, filled with epoxy and painted over. This is an illegal repair according to FAA part 121 regulations.



ITEM #2: SKIN CORROSION AT STA 540 BETWEEN S-23R TO S26R

The extent and severity of this untreated corrosion is an airworthiness violation.



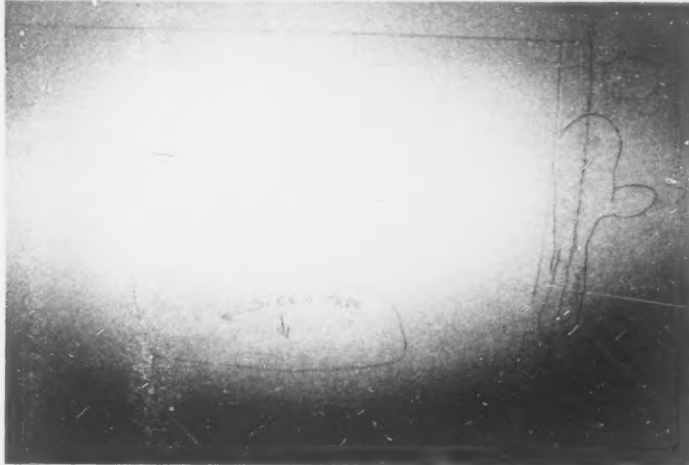
ITEM #3: FWD BAGGAGE DOOR "C-1" SKIN CORRODED

This corrosion is simply smoothed over with epoxy and painted. This is an unacceptable fix in a critical area.



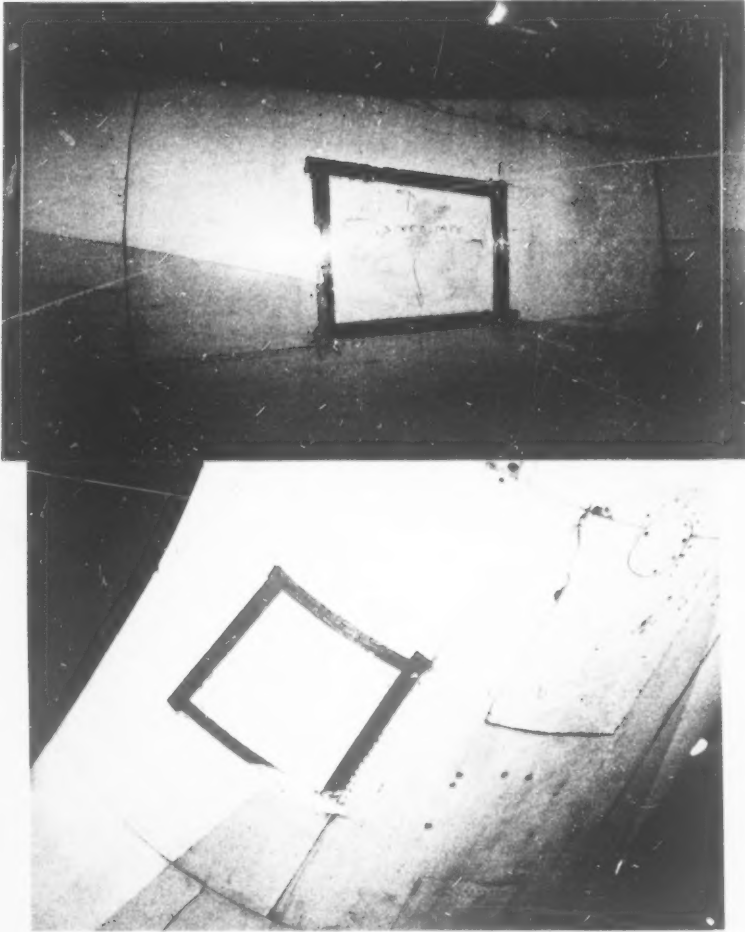
ITEM #S 7 AND 8: S/M REPAIR ON AFT FRAME OF C-1 DOOR CORRODED
AND 2 SPEED TAPE PATCHES BETWEEN STA 600-600D
AT S24/25

This untreated door frame corrosion is on a joint that is already patched.
The speed tape patches are painted over to hide an improper repair.
Either of these two items would ground a plane operated under part 121.



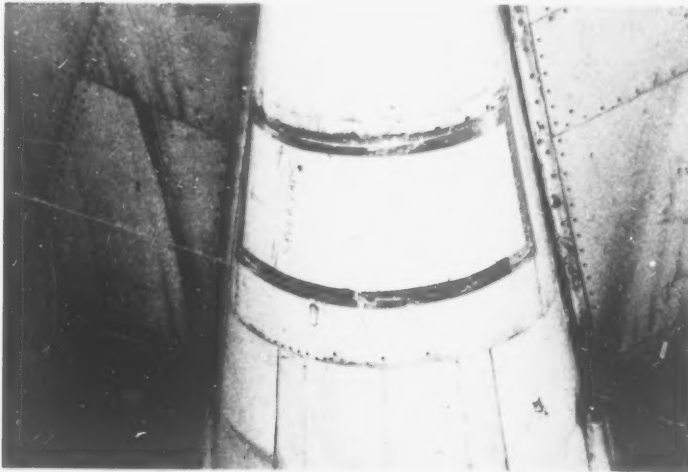
ITEM # 12: ACCESS PLATE # 1185 INSTALLED WITH SPEED TAPE
(STABILIZER COMPARTMENT ACCESS PANEL)

This is a large aluminium access panel that is exposed to six hundred mile per hour winds. The fasteners to hold the panel are stripped and or loose so speed tape is used to hold the panel. This is not an acceptable repair.



ITEM # 13: ACCESS PLATE # 1188 INSTALLED WITH SPEED TAPE (TAIL
CONE COMPARTMENT ACCESS PANEL)

This is a large aluminium access panel that is exposed to six hundred mile per hour winds. The fasteners to hold the panel are stripped and or loose so speed tape is used to hold the panel. This is an unacceptable and dangerous repair.



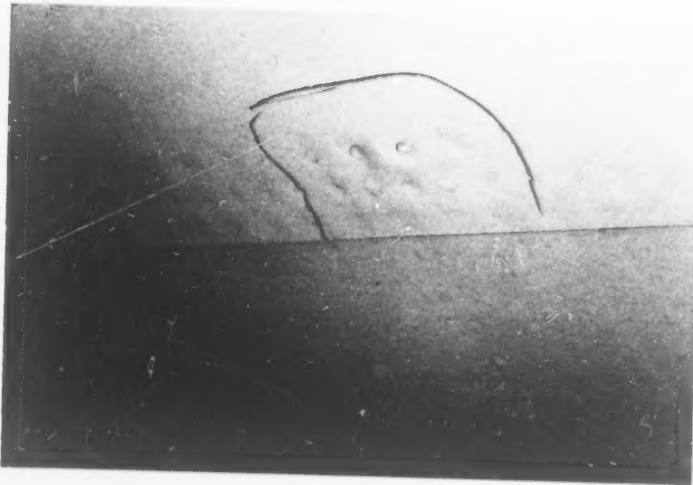
ITEM # 14: WING ROOT TO FUSELAGE WRAP AROUND PANEL #1157
CRACKED.

This crack was not repaired. The pictures shows that epoxy and paint were used to conceal the crack.



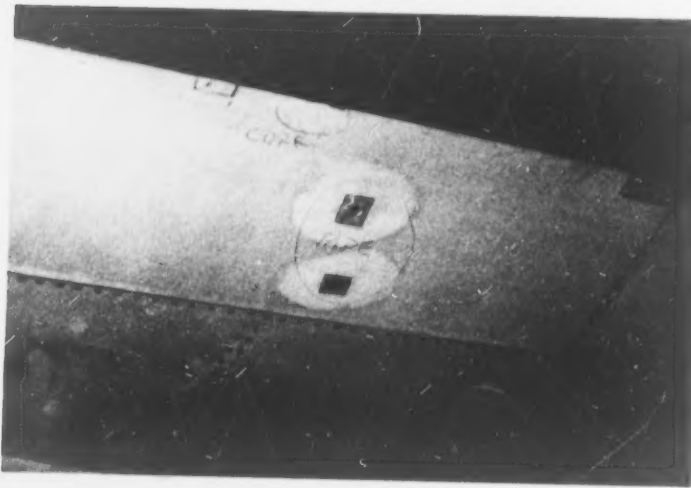
ITEM # 17: RIVETS SUCKED IN AT STA 580/600 S-27L

The significance of these rivets being sucked in is that it is evidence of heavy corrosion. These rivets should be repaired immediately since they make the aircraft unairworthy.



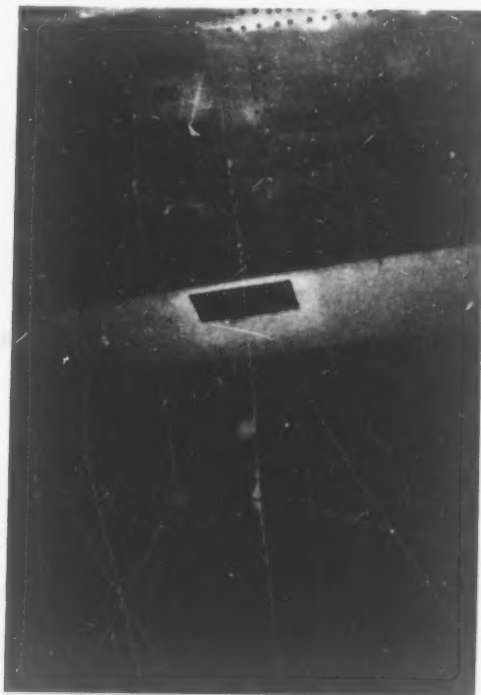
ITEM #20: LEFT WING FILET FLAP HAS NUMEROUS TRAILING EDGE SPEED TAPE PATCHES.

Speed tape is only to be used on control surfaces for emergency repairs. It is unlikely that all these patches were put on just prior to this plane entering our hangar. Any 121 regulated aircraft with these speed tape patches on the control surfaces would be grounded.



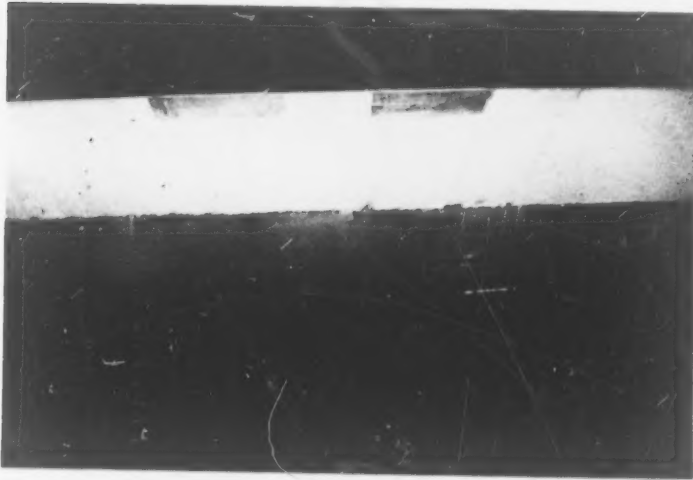
ITEM #21: LEFT WING INBOARD AILERON HAS NUMEROUS SPEED TAPE
PATCHES AND OTHER IMPROPER PATCHES

Some of these patches are speed tape over speed tape. These are clearly illegal. Flight control surfaces are critical, you cannot just tape up holes in these surfaces and continue flying. Part 121 operators must repair control surfaces in accordance with FAA regulations and even ensure that the control surface is in balance after the repair. These surfaces have not been properly repaired and they certainly have not been checked to see if they are in balance.



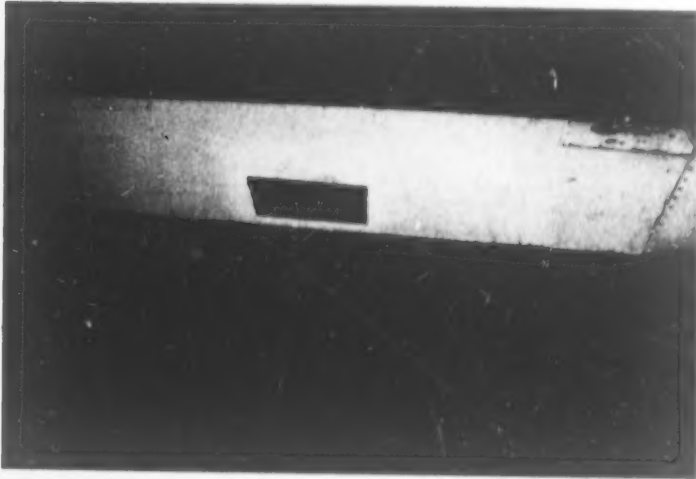
ITEM #22 LEFT WING OUTBOARD FLAP HAS NUMEROUS IMPROPER
PATCHES.

This control surface is like the others, covered with numerous illegal speed
tape repairs and scab patches.



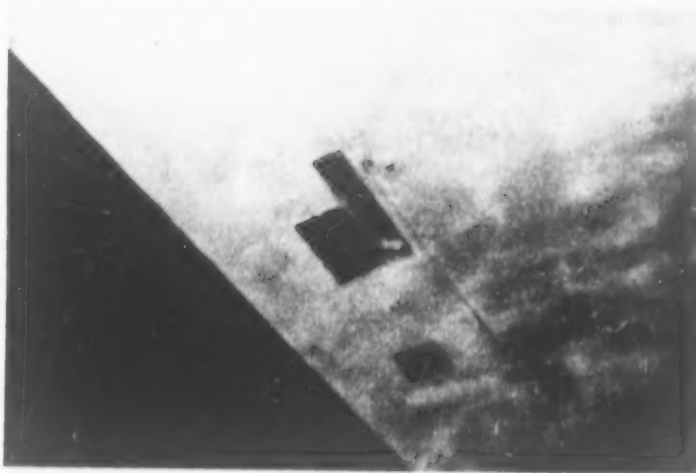
ITEM #23: LEFT WING OUTBOARD AILERON HAS NUMEROUS IMPROPER
REPAIRS

This critical control surface has speed tape wrapped around the trailing edge as well as extensive de-lamination. It is unacceptable to try to patch de-lamination with speed tape.



ITEM #27: RIGHT WING INBOARD FLAP HAS NUMEROUS SPEED TAPE
REPAIRS

Once again we see speed tape patches on flight controls. For a 121
regulated carrier, this is a grounding item.



ITEM #32: HI-LOCK RIVETS PROTRUDING FROM FUEL TANK AT FRONT SPAR WITH DIMPLED WASHERS UNDERNEATH - ONE OUTBOARD OF #2 LEADING EDGE FLAP AND ONE AT MIDDLE OF #9 LEADING EDGE SLAT. (pictures on this and next page)

The pictures shows these two hi-lock rivets with dimple washers protruding from a fuel tank. The use of the dimple washers shows that the hole in the fuel tank is bigger than the rivets and the rivet head was pulling through the wing skin into the fuel tank. The washer makes the head of the rivet bigger so that it does not pull through the skin. This is an illegal repair. The hole should be enlarged to the next size rivet, examined for evidence of cracks and corrosion and then the proper size rivet should be installed. This is a cheap and dirty fix that is unacceptable and would ground a 121 operator.



ITEM #32: CONTINUED



ITEM #33: RIVETS EXCESSIVELY LOOSE ON #4 ENGINE PYLON

The pictures shows streaks flowing backward from each rivet. This is evidence that these rivets are loose and there is a good possibility corrosion is forming behind the rivets. Also, on the top of the picture there is corrosion on the joint.



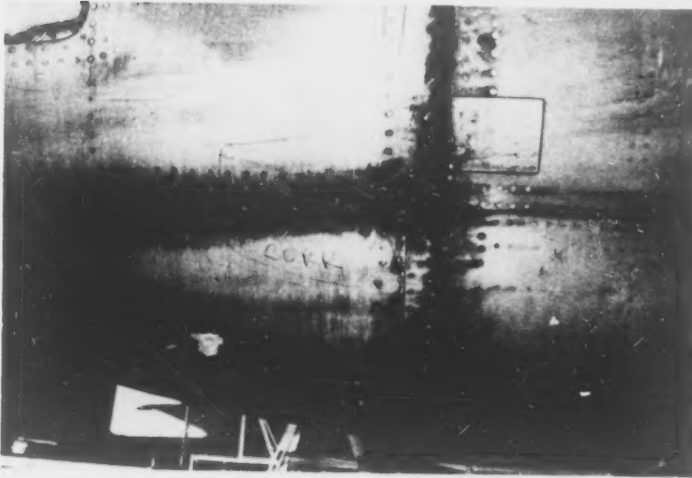
ITEM #34: #2 ENGINE REVERSER OUTBOARD FORWARD. IMPROPER
REPAIR, LOOSE RIVETS AND CORROSION.

The picture clearly shows two sheet metal "scab" patches on top of one large sheet metal repair. This is an unacceptable repair. The picture also shows quite a bit of corrosion.



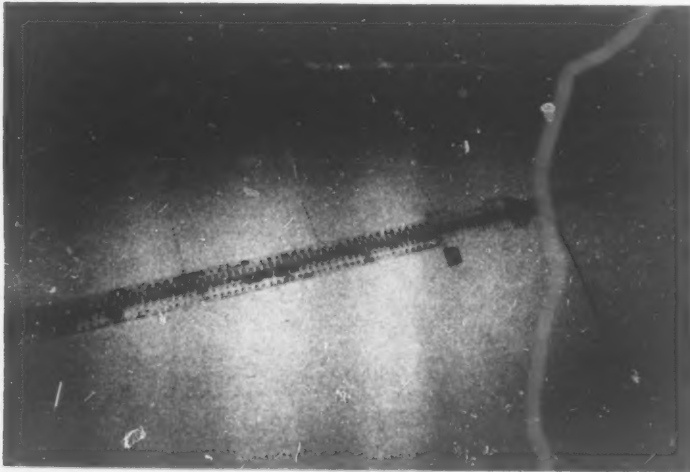
ITEM #35: #2 ENGINE AFT REVERSER, INBOUND, FORWARD. IMPROPER REPAIR, LOOSE AND MISSING RIVETS AND CORROSION.

The picture shows extensive corrosion of the reverser joint as well as an unacceptable scab patch.



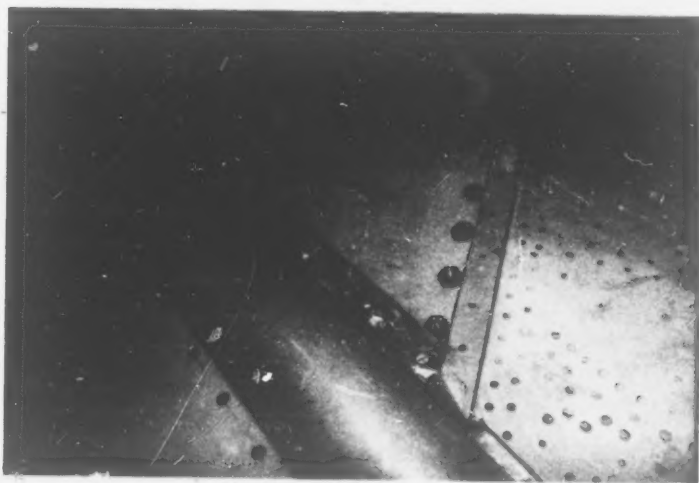
ITEM #45: MAIN CARGO DOOR HINGE CORRODED.

This hinge is in a critical area, near the crown skin, and yet the extensive corrosion has not been repaired. This is a grounding item.



ITEM #46: STRUT TO WING WRAP AROUND PANELS, FASTENER'S HELD IN PLACE WITH SPEED TAPE.

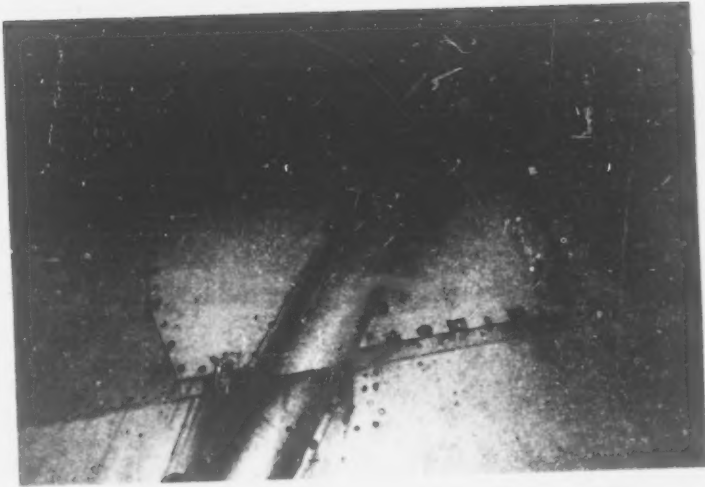
These four pictures on the next three pages show that fasteners necessary to hold in these fairings are loose and simply held in with speed tape. The fairings are in the slipstream of the aircraft and they need to be firmly attached to the wings. There was no attempt to repair these fasteners and correctly secure the fairings, they were taped in to make a quick, cheap "fix." (pictures on this and next three pages)



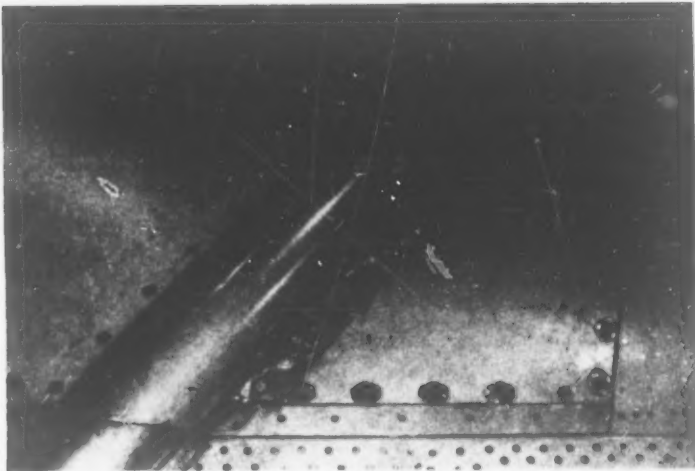
ITEM #46: CONTINUED



ITEM #46: CONTINUED

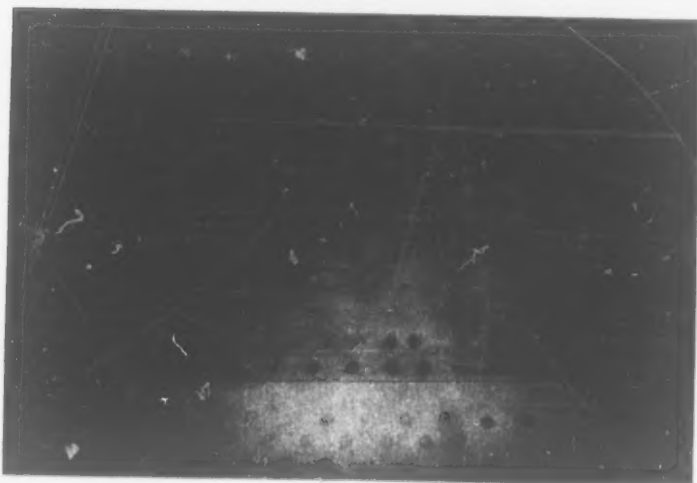


ITEM #46: CONTINUED



ITEM #47: RIGHT WING INBOARD UPPER SURFACE CORROSION AND SPEED
TAPE PATCHES.

These pictures show unairworthy speed tape repairs and attempts to cover up corrosion with tape. Covering corrosion with speed tape does not make the problem go away and it is not an acceptable repair.



ITEM #48: NO EMERGENCY RED MARK AT WINDOW AND HANDLE-COCKPIT
AREA, EXTERIOR RIGHT HAND SIDE.

These required safety markings are left off the aircraft. A visible sign of
immunity from compliance with FAA safety regulations.



Statement of
David H. Treitel
Executive Vice President
SH&E, Inc.

Before the
Aviation Subcommittee
Public Works and Transportation Committee
United States House of Representatives

Hearings on "U.S. International Aviation Policy"

May 9, 1991

SH&E, Inc.
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New York, New York 10016
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SH&E

Mr. Chairman and Members of the Subcommittee:

I was delighted to receive your invitation to appear before this Subcommittee. I appreciate the opportunity to express my views and assist in your evaluation of U.S. international aviation policy.

I am Executive Vice President of Simat, Helliesen & Eichner, Inc. (SH&E), which is one of the world's leading economic research and management consulting firms specializing in commercial aviation. Since joining SH&E in 1977, I have been involved in several hundred assignments concerning commercial aviation in the U.S. and around the world. Clients for these assignments have included U.S. and foreign airlines, entrepreneurs, aircraft manufacturers, financial institutions, and the Department of Transportation, among others. In addition, I have appeared as an expert witness in proceedings before the Department of Transportation and in State and Local courts.

In the last few years, I have been involved in assignments which contributed to the consolidation of the U.S. industry, helped privatize several foreign carriers, and assisted industry participants in responding to an evolving structure. I have assisted financial institutions evaluate and pursue opportunities in the aviation industry.

I appear today on my own behalf as an expert in the industry. While some of my clients may concur, the views I express are my own.

My remarks are directed at two key issues: foreign ownership of U.S. airlines and cabotage. I believe that U.S. international aviation policy must allow foreign interests to purchase larger stakes — even controlling stakes — in U.S. airlines. The U.S. airline industry has enormous capital requirements in the 1990's. The industry's earnings have not been large enough to attract enough capital from traditional sources. Foreign capital — especially equity capital — is a new source which can be tapped to fill the U.S. industry's capital shortfall which will be as large as \$11.7 billion per annum in the 1990's.

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An important corollary to allowing foreign ownership of U.S. airlines concerns cabotage. Provided that the U.S. government insures that there are equivalent and reciprocal arrangements for U.S. airlines, cabotage is a vehicle to open new markets for U.S. airlines, create additional job opportunities and control labor cost increases.

I. THE U.S. AIRLINE INDUSTRY'S CAPITAL REQUIREMENTS

The U.S. and the world's airline industry face enormous capital requirements over the next decade. Boeing's Current Market Outlook shows that U.S. airlines' new aircraft investment has increased from \$4.8 billion per year in the 1970's, to \$7.6 billion per year in the 1980's, to a projected level of \$16.3 billion per year in the 1990's. This 114% increase in capital requirements for new aircraft compares to a 77% increase in U.S. industry revenue passenger-miles between 1980 and 1990.¹

As of February 15, 1991, the U.S. scheduled airlines have \$165.2 billion of aircraft on order and option, compared to \$19.8 billion at the end of 1983 (Table 1). Four carriers have more than \$20 billion of aircraft on order and option: United has nearly \$45 billion, American has \$23 billion, Delta has nearly \$26 billion and Northwest has over \$21 billion.

TABLE 1
COMPARISON OF U.S. SCHEDULED AIRLINES
AIRCRAFT ORDERS & OPTIONS

	YE 1983		February 15, 1991	
	# of Aircraft	Estimated Value* (\$ Billions)	# of Aircraft	Estimated Value* (\$ Billions)
Aircraft Orders	288	\$11.6	1,315	\$82.4
Aircraft Options	218	8.2	1,371	82.8
TOTAL	506	19.8	2,686	\$165.2

* Includes estimated value of spares, spare engines & associated property and equipment

Source: Airline Economics, The Airline Quarterly, Winter 1990-91, p. 61.

¹Source: CAB/DOT, Air Carrier Traffic Statistics, September 1980 and September 1990.

The industry's new aircraft requirements are the result of two critical factors: growth (e.g., expansion) and replacement. The FAA forecasts that U.S. air carrier revenue passenger-miles will grow at 4.8% per annum between 1990 and 2002.² Boeing's forecast is somewhat slower, averaging 4.7% per annum in the same period.³

The U.S. air carrier fleet is the world's oldest with an average age of 13 years. Nearly two-thirds of the airplanes that are over 20 years old are in the U.S.⁴ Replacing older aircraft will be an important use of the new aircraft deliveries. SH&E has projected that 44% of the new aircraft deliveries will be for replacement in the 1990's, compared to 28% in the 1980's.

In addition to the capital required for new aircraft, the U.S. carriers have a need for new ground property, equipment and other assets. These assets typically amount to 30% of flight equipment. Hence, the U.S. carrier's requirements for capital expenditures will be 30% higher in the 1990's than the \$16.3 billion projected by Boeing, or \$21.2 billion per year.

II. CAPITAL SOURCES

The U.S. airline industry will have difficulty in obtaining the capital required to finance the \$21.2 billion per annum in capital expenditures that is expected in the 1990's. Table 2 shows that the U.S. airlines will be able to finance approximately \$9.5 billion of the annual \$21.2 billion capital requirement from traditional sources without overleveraging their balance sheets. The balance, \$11.7 billion, is the unfunded or extra capital requirement – the amount needed beyond that which the industry can finance through traditional means.

²FAA, FAA Aviation Forecasts, Fiscal Years 1991-2002, February 1991, p. 8.

³Boeing, Current Market Outlook, February 1991, p. 82.

⁴Boeing, ibid., p. 44.

TABLE 2
U.S. AIRLINE INDUSTRY FINANCING REQUIREMENTS

<u>Lines</u>	<u>Item</u>	<u>Amount</u>	<u>Source</u>
1.	Estimated 1991/92 U.S. Industry Revenues (millions)	\$80,000	SH&E estimate
2.	Normalized Net Margin	1.5%	SH&E estimate
3.	Normalized Net Income (millions)	\$1,125	Line (1) x Line (2)
4.	Estimated 1991/92 U.S. Industry Depreciation (millions)	\$4,300	SH&E estimate
5.	Estimated 1991/92 U.S. Industry Cash Flow From Operations (millions)	\$5,425	Line (3) + Line (4)
6.	Estimated 1991/92 U.S. Industry Investment Capacity (millions)	\$9,500	Line (5) x 175%
7.	Estimated U.S. Industry Capital Requirements (millions)	\$21,200	SH&E estimate
8.	Estimated U.S. Industry Unfunded Capital Requirement	\$11,700	Line (7) - Line (6)

There are several mechanisms which might be used to fund this annual \$11.7 billion capital requirement. The industry is likely to increase its leverage. Assets will be sold, especially older equipment. New sources of capital – especially equity capital – might be attracted to the industry from foreign parties, the public markets, or government. Other capital sources include tax credits and leases.

Many of these sources are already being tapped. American, United and Delta have all recently completed large public equity offerings. Increasingly, U.S. airlines are leasing rather than purchasing their equipment. In April 1989, 39% of the U.S. fleet was leased. In January 1990, that percentage had increased to 48%.

Even so, the capital markets will be strained to fund the industry's capital requirements in the 1990's. Already, the strongest U.S. carriers are experiencing increasing

interest rates and, in some cases, lower debt ratings (Table 3).

TABLE 3
COMPARISON OF INTEREST RATES - SELECTED AIRLINE BONDS

Company	Issue	Yield to Maturity		S&P Rating	
		Dec. 1989	Feb. 1991	Dec. 1989	Feb. 1991
American Airlines	Sub Deb 6¼ %	8.70%	10.38%	A-	BBB+
AMR Corp.	SF Deb 8% 2017	9.32%	9.75%	A	A-
Delta Airlines	Deb 9% 2016	9.05%	10.50%	A	A
U.S. Air, Inc.	Sr Deb 12% 2000	11.23%	13.25%	BBB+	BBB-
U.S. Government	Long-term bonds	8.10%	8.38%	-	-

Source: Standard & Poor's Corporation, Bond Guide.

Aircraft lessors are nervous as a result of the varying interpretations of Section 1110 of the Bankruptcy Code, the dramatic fall in the value of used aircraft, and the rising inventory of aircraft for sale or lease. New sources of capital will have to be found and developed to provide for the U.S. industry's capital needs in the 1990's.

III. FOREIGN AIRLINE RETURNS FROM U.S. AIRLINE INVESTMENT

One source of capital that might be expanded in the 1990's is foreign investment. Already, Japanese and European banks, equipment manufacturers, and governments are important providers of debt and lease capital to support U.S. airline fleet acquisition programs. In addition, there have been several foreign airline investments in U.S. airlines, including:

- (1) A direct investment by Singapore Airlines and SwissAir in Delta;
- (2) A direct investment by Ansett in America West;

- (3) A direct investment by SAS in Continental;
- (4) A direct investment by KLM in Northwest; and
- (5) An indirect investment by Japan Air Lines in Hawaiian Airlines.

The direct returns on these investments have not been especially attractive, on balance. Singapore and Swissair have profited slightly, but Ansett, Hawaiian and Japan Airlines have lost handsomely. No return is available from objective sources on the KLM investment in Northwest, although the value of that position has certainly declined (Table 4).

TABLE 4
DIRECT FOREIGN AIRLINE RETURNS
ON U.S. INVESTMENTS

<u>Carrier</u>	<u>Investment</u>	<u>Per Share Value</u>	<u>Announcement Date</u>	<u>Per Share Value at 5/7/91</u>
Singapore	5% of Delta	\$72.57	10/26/89	\$73.63
SwissAir	5% of Delta	\$77.36	7/10/89	\$73.63
Ansett	20% of America West	\$10.50	6/19/87	\$ 6.50
SAS	16.8% of Continental	\$14*	Various*	\$ 2.50
KLM	20% of Northwest	\$400 million	6/14/89	N.A.
JAL	20% of Hawaiian	\$40	5/27/88	\$ 9.38

* SAS's last purchase of SAS stock was on 8/8/90 when it acquired 5.2% of Continental Airlines Holdings at \$14 per share from Frank Lorenzo and two partners.

The poor investment performance that has been experienced does not mean that there will be no foreign interest in acquiring shares in U.S. airlines. There are strategic issues which will encourage such investments. Indeed, the SAS/Continental marketing agreement has been extremely successful in increasing SAS's penetration into the U.S.

market. By switching its New York service to Newark and establishing a marketing alliance with Continental, SAS has been able to:

- (1) Increase daily New York-Scandinavia service to four flights, a 25% improvement over its pre-alliance 1988 service level;
- (2) Provide connecting service to 84 cities at Newark in October 1990, compared to 63 cities at JFK in October 1988; and
- (3) Transport more connecting passengers. In the first half of 1990, 40,300 passengers connected to SAS at Newark, up 68% from the 24,800 passengers that connected to SAS at JFK, two years earlier. Forty percent of SAS's Newark connections involved Continental, its strategic partners.

The strategic benefits of marketing alliances are large enough to encourage carriers to cement those relationships with equity investment. Clearly, British Airways would have liked to be in a position to influence United's decision regarding the acquisition of Pan Am's London routes as the British Airways/United marketing arrangement will be seriously jeopardized by conflicts of interest. In an analogous situation, the U.S. airlines found it necessary in many cases to acquire controlling interests in their regional airline partners to protect the strategic benefits of their marketing alliances.

IV. U.S. AIRLINE PRODUCTIVITY AND EFFICIENCY

The U.S. airlines are very strong competitors. Virtually without exception, the U.S. airlines produce seat miles at lower cost than do their foreign airline competitors when measured against trip length to adjust for route structure influence upon unit costs (Figure 1). Indeed, the U.S. airline cost curve is between 20 and 25 percent lower than the foreign airline cost curve (Figure 2).

There are many reasons for the U.S. airline cost efficiency. Despite relatively high average employee compensation, U.S. airline employees' productivity is well above world averages (Figure 3). U.S. airline employees are between 60 and 75 percent more productive than their foreign airline counterparts (Figure 4).

V. U.S. AIRLINE INTERNATIONAL COMPETITIVENESS

The U.S. airlines are extremely effective competitors. They have been extremely innovative, developing complex fare structures which target specific market segments, inventory control and yield management systems which enhance revenue without impairing traffic, CRS systems which have automated the industry's marketing and distribution channels, and Frequent Traveller programs which have set a new standard for programs that create brand loyalty.

In international markets, the U.S. carriers have gotten stronger as they have used their strong hub-and-spoke systems to feed their international flights. These on-line traffic collection systems have enabled the U.S. carriers to improve their competitiveness in all world regions, even the U.S.-Europe markets in which U.S. carriers have been severely impacted by the travelling public's lingering reaction to terrorist incidents against TWA in 1985 and 1986 and against Pan Am in 1988 (Table 5).

TABLE 5
INCREASING U.S. CARRIER INTERNATIONAL MARKET COMPETITIVENESS

	Percent U.S. <u>Carriers</u>	Percent U.S. <u>Citizen</u>	<u>GAP</u>
<u>A. U.S. - Europe</u>			
1986	43.3	57.5	-14.2
1987	46.3	57.4	-11.1
1988	49.2	53.3	-4.1
1989	46.9	53.6	-6.7
1990	46.3	53.8	-7.5
<u>B. U.S. - Far East</u>			
1986	40.7	42.6	-1.9
1987	41.4	40.1	+1.3
1988	45.6	37.0	+8.6
1989	49.0	34.4	+14.6
1990	53.8	32.5	+21.3
<u>C. U.S. - South America</u>			
1986	44.1	44.9	-0.8
1987	45.0	48.2	-3.2
1988	43.8	48.5	-4.7
1989	39.8	45.5	-5.7
1990	43.3	41.8	+1.5
<u>D. U.S. - Australia/Oceania</u>			
1986	45.7	54.0	-8.3
1987	48.3	51.8	-3.5
1988	41.2	51.3	-0.1
1989	57.1	48.2	+8.9
1990	60.6	46.1	+14.5

Source: Ins Data on I.P. Sharp

OPERATING COST PER ASK ADJUSTED FOR TRIP LENGTH -- 1989

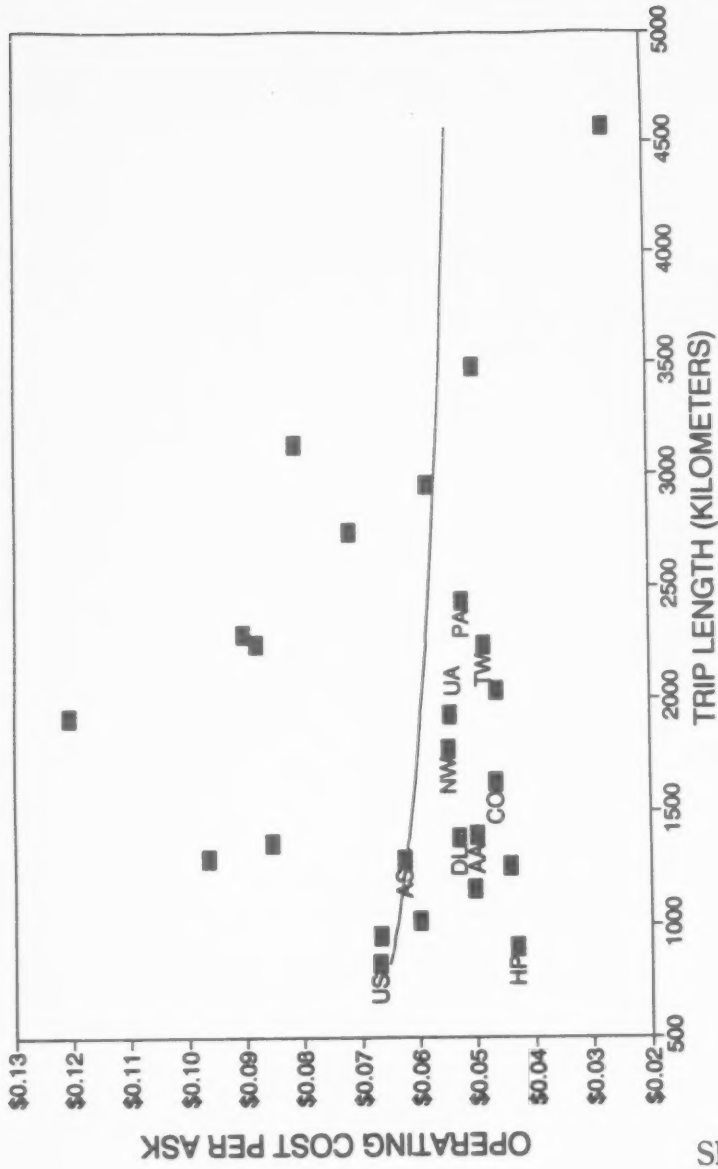


Figure 1

Figure 2

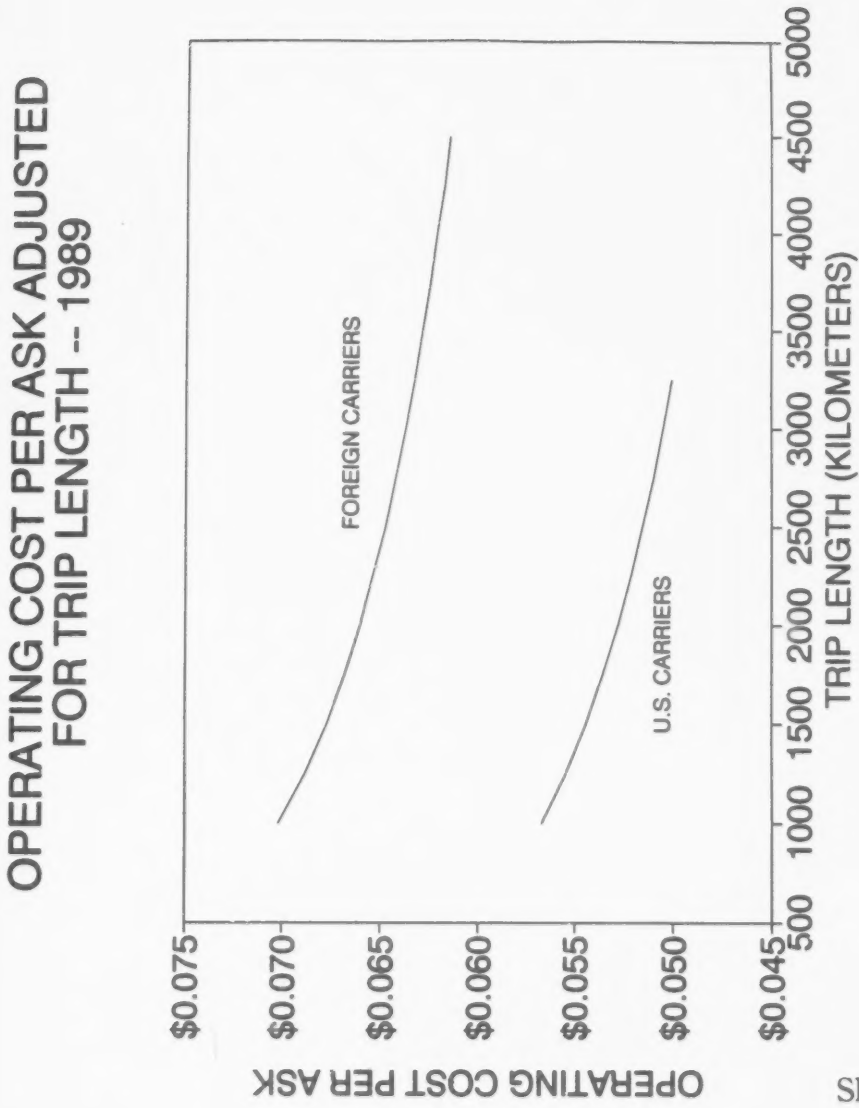
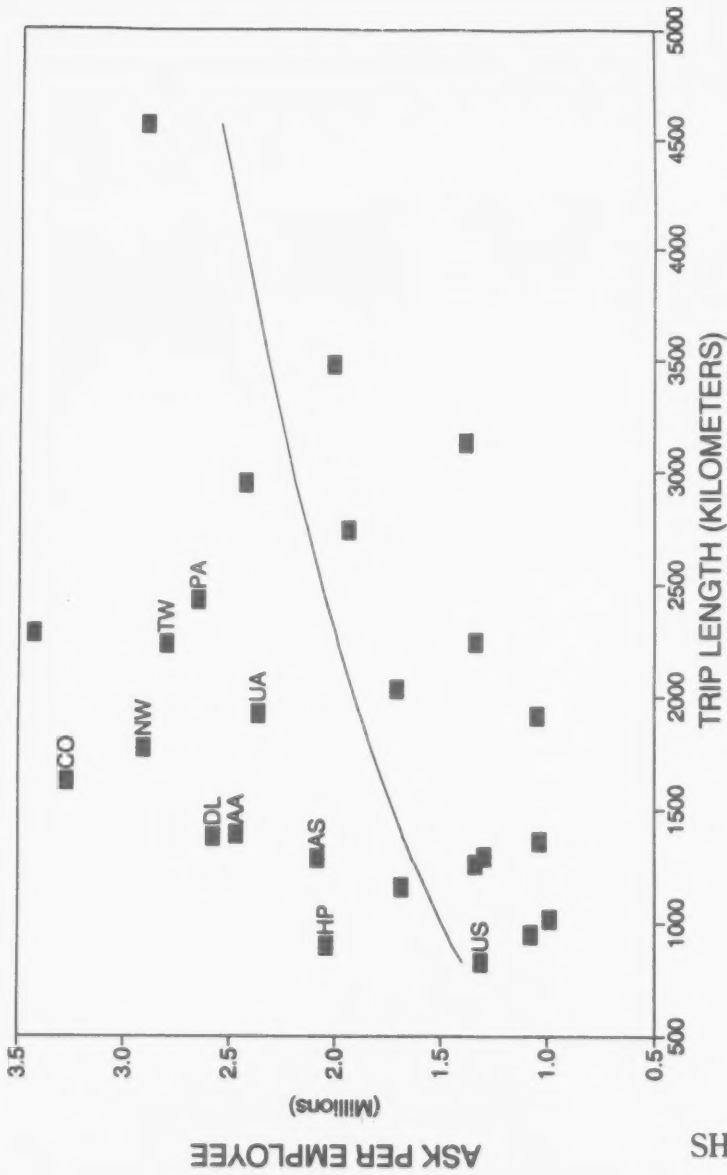


Figure 3

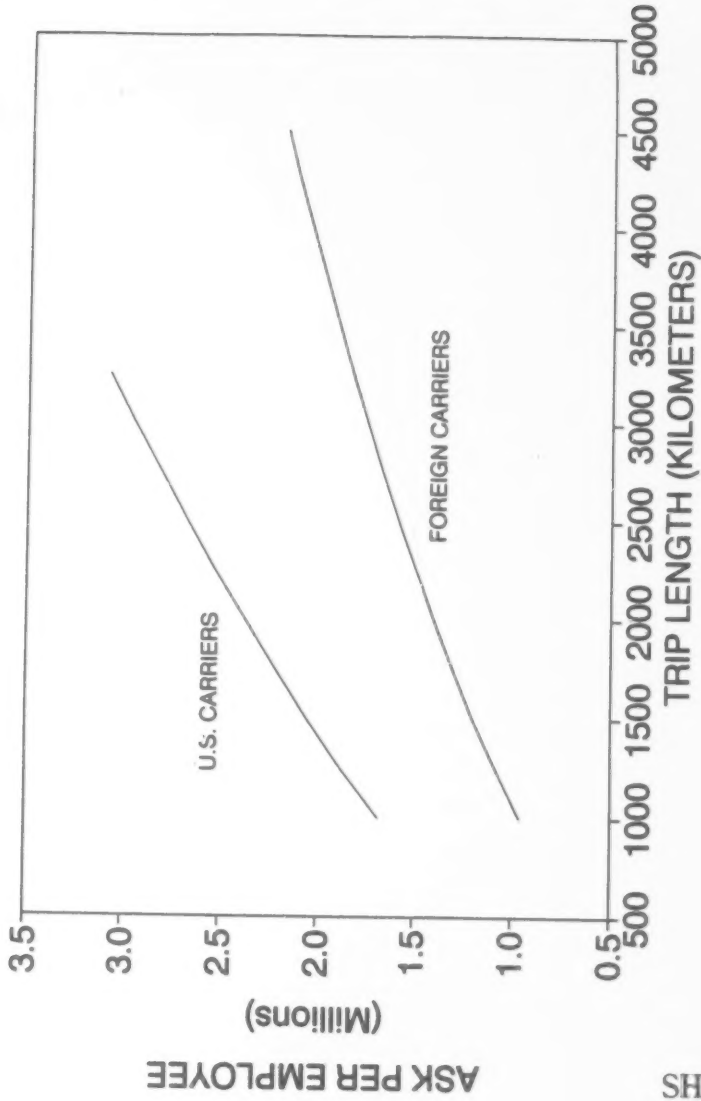
ASK PER EMPLOYEE ADJUSTED FOR TRIP LENGTH -- 1989



E&S

Figure 4

ASK PER EMPLOYEE ADJUSTED FOR TRIP LENGTH -- 1989



SH&E

The story in the U.S. - Japan market is one which shows the growing competitive strength of the U.S. carriers. Since 1985, this market has nearly doubled. The U.S. share of the market has increased from less than 48% in 1985 to 55% in 1990. U.S. carriers have not only increased their share of U.S. citizen traffic but have also increased their share of non-U.S. citizen traffic from less than 38% in 1985 to 50% in 1990 (Figure 5).

Similar stories of increasing U.S. carrier competitiveness exist in each world area, with the exception of Europe. Terrorism – or the fear of terrorism – has helped offset the effectiveness of U.S. carrier competition. In the U.S. - U.K. market, for example, the U.S. carriers had a positive share gap in the 1982-1986 period. However, that gap became negative in 1987 following the second incident involving TWA in 1986. It went even further negative in 1988 and 1989 after the Pan Am bombing. The travelling public's fear of flying U.S. carriers has impaired the competitiveness of the U.S. carriers – especially Pan Am and TWA – in U.S.-Europe services.

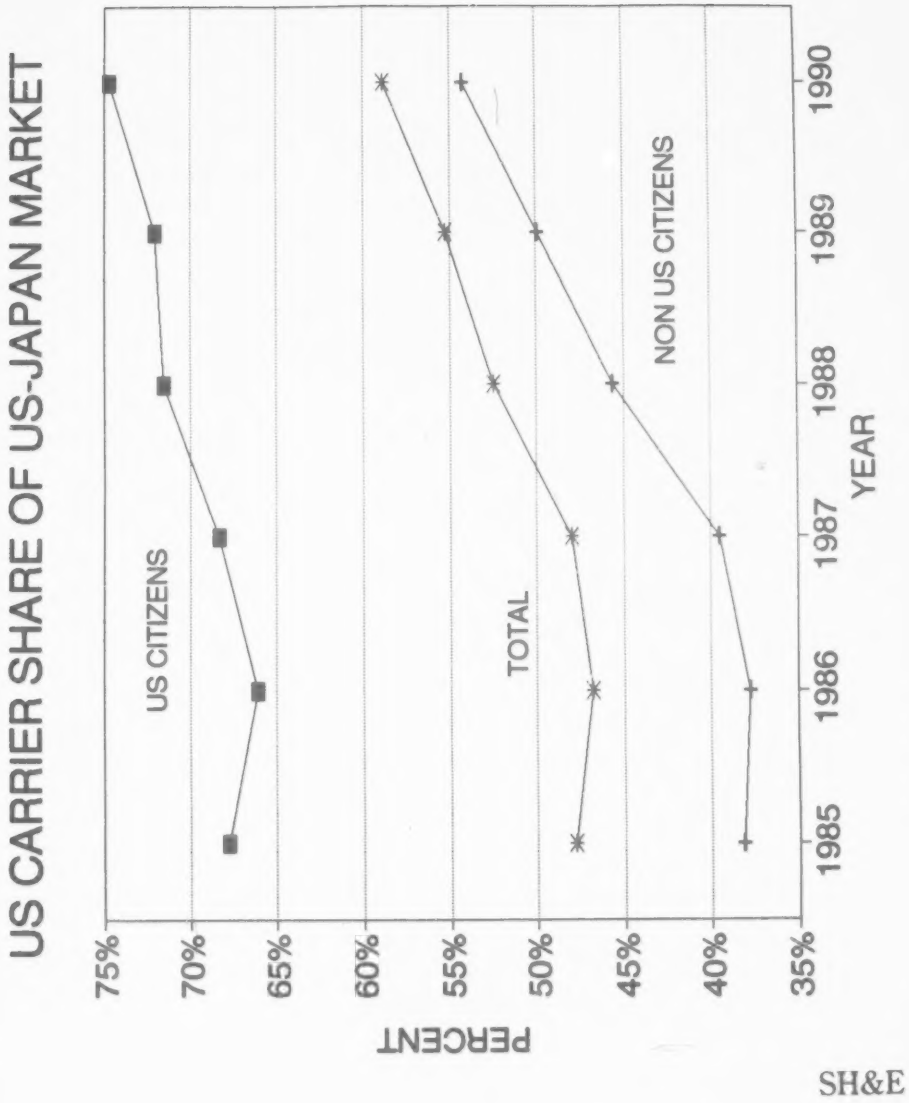
VI. CONCLUSIONS

A. Foreign Ownership

U.S. international aviation policy must be flexible so that it can respond to the ever changing needs of U.S. airlines and the travelling public. U.S. international aviation policy needs to be altered to encourage the flow of capital to U.S. airlines thereby enabling the U.S. airline industry to acquire the aircraft needed to replace an aging noisy fleet and to grow to accommodate increasing demand. Laws restricting the level of U.S. airline ownership by foreign parties need to be altered so that the U.S. airline industry has the flexibility to attract capital – especially equity capital – from sources that would otherwise be unavailable to it.

The new policy set forth by Secretary Skinner earlier this year does not go far enough, in my opinion, to provide sufficient flexibility to attract foreign capital to U.S.

Figure 5



airlines. While current law limits foreign ownership of voting stock in U.S. airlines to 25%, there is no reason to restrict non-voting stock to 49% of total equity. Such restriction may inhibit the ability of the capital markets to develop securities (i.e., high yield, preferred instruments, or payment-in-kind preferred stock, etc.) that might help the U.S. airline industry attract capital and would allow the capital markets to work without this impedance. Under the new policy, airlines will continue to rely on unrestricted lease and debt financing. Removing the artificial restriction on equity will allow firms to make financing decisions based on economic and business criteria.

The legislation that has been proposed (i.e., HR2074 and 782) that allows foreign parties to acquire 49% of the voting stock of U.S. airlines may not be sufficient to attract the equity investment in U.S. airlines unless it constitutes effective control of that airline. The experience of Ansett, SAS and Japan Airlines, with investments in America West, Continental and Hawaiian respectively, may be lessons to other foreign airlines that will deter them from holding non-controlling minority positions in other U.S. airlines.

Moreover, the call for reciprocity with respect to foreign ownership that is also part of the proposed legislation, in my opinion, discriminates against the airline industry. There is no such legislation that impacts the tire industry or the automobile industry, industries that have had foreign owned companies acquire U.S. companies.

B. Cabotage

Foreign control of U.S. airlines obviously must consider many other factors besides creating new sources of capital. For example, national defense, cabotage and unfair competition from subsidized airlines must clearly be considered carefully. The cabotage issue, in particular, is one that is commanding much attention. It may very well be in the interest of the U.S. to allow cabotage in some instances as a means of promoting more competition in the U.S. marketplace while, at the same time, providing more expansion opportunities for U.S. carriers. Indeed, cabotage may be an effective mechanism of

controlling labor cost increases and also creating more job opportunities.

U.S. airlines have the most productive work forces and are among the most cost efficient carriers in the world. U.S. carriers are very effective marketers, leading in the development of attractive fares and fare structures, innovative marketing ideas such as the Frequent Traveller program and automating the industry's distribution system with the CRS's. They often obtain market share premiums in international markets. Clearly, with these advantages, the U.S. airlines will benefit from cabotage, provided that the cabotage opportunities are equal for U.S. and foreign carriers. Balancing cabotage opportunities will be a difficult policy to administer, but will provide growth opportunities for U.S. carriers.

Mr. Chairman, thank you for the opportunity to express my views on this critical issue.



Global Aviation Associates, Ltd.

STATEMENT OF JUDITH M. TRENT
MANAGING DIRECTOR
GLOBAL AVIATION ASSOCIATES, LTD.

BEFORE THE
HOUSE PUBLIC WORKS AND TRANSPORTATION COMMITTEE
SUBCOMMITTEE ON AVIATION

May 9, 1991

Introduction

Mr. Chairman, Members of the Subcommittee, I appreciate the opportunity to appear before you today to share some views on the trends and future of international aviation policy.

I am Judith M. Trent, Managing Director of Global Aviation Associates, Ltd., an aviation consulting firm which has its main office in Washington, and staff in Brussels, Geneva and London. Previously, I was Assistant Secretary of the Department of Transportation for Policy and International Affairs (1981-1983) and for Environment, Safety and Consumer Affairs (1975-1977). I have also been employed by Pan Am (1977-1981) and TWA (1968-69).

The Premise

As a long time participant in the field of aviation, I have watched the industry making a slow and sometimes painful transition from being highly regulated, with limited market opportunities defined and protected from competition, to an industry that is mature in its ability to compete and, for the most part, anxious to do so. I believe the trend toward open markets is the correct one, is inevitable, and should be permitted to progress as rapidly as possible, without undue regulatory constraint, but within the normal public interest tests that apply to all other industries.

The Think Tank

I am not alone in this belief. Today, I would like to tell you briefly about the results of a series of sessions that were held last year under the auspices of our European offices, to consider the economic regulatory impediments to the expansion of air transport services. Members of the group, which we refer to as the "Think Tank," were admittedly of the more liberal persuasion. They included the Chairman, Hans Raben, who is the former Director General of Civil Aviation for the Netherlands, as well as representatives from U.S. airlines (American, Delta), airlines from Europe and Asia (UTA, ANA), and former government officials in aviation from the U.S., U.K., Ireland and Australia. A list of the individuals who participated in the deliberations of the Think Tank is contained in the final report, copies of which I have provided to the committee.

The origin of the Think Tank was in the Chairman's earlier suggestion that a group of independently-minded people from around the world should take a fresh look at the prospects for multilateral solutions to aviation regulation. The group examined the arguments for liberal rather than protectionist aviation policies, then considered multilateral rather than bilateral approaches, and finally, made an effort to develop the essential elements of a liberal multilateral.

The group came to the following basic conclusions, which I derive from the Think Tank's final report.

Moves to Freer Trade

Free trade policies are being applied around the world, with deregulation of business a central feature. In fact, we are increasingly seeing a move toward "economic disengagement" of governments around the world. Thus, the deregulation of domestic air transport in several countries must be seen as part of the

much more widespread and general move towards the withdrawal of governments from the regulation of industry and commerce. Air transport liberalization of domestic markets is a coming reality in North America (U.S., Mexico and Canada), the European Community and Australasia (Japan, Australia, and New Zealand). As many as 40 airlines around the world are moving towards private ownership. This move towards the privatization of airlines has diverse motives, but a change in political philosophy is certainly encouraged by a need to escape from the obligations to provide very large additional investments in fleet renewals---particularly if there is reason to suspect that the air carrier is less than efficient in its operations.

We have seen the interests in this country shift somewhat in recent years, as concerns about local and regional economic development have emerged as a priority in international aviation policy. Pressures mounted by cities for increased and improved air services have certainly encouraged a move away from established national policies which restricted access to the United States on the basis of a traditional balance of revenue or traffic benefits to the affected air carriers.

In sum, the case for freer trade is gaining increased acceptance throughout the world and greater liberalization in international aviation policies is widely accepted to be better than protectionism. The major unresolved issue is how to best achieve a progressive liberalization of air transport regulation.

Bilateralism versus Multilateralism

The fundamental observation was that the traditional system of aviation regulation is constraining the growth and development of air transport. The airline industry has matured. Its markets have become global and interdependent. The marketplace

changes with increasing speed and growing complexity. In short, the bilateral system is too cumbersome for today's global market-oriented airline and unsuited for a mature industry.

While close economic regulation has produced an orderly growth of aviation over the years, elements such as government ownership of airlines and bilateral trading of air service rights lead too readily to protectionism.

Bilateral restrictions on market entry, price and capacity have been easing over the years but the process is slow, limited in scope, bureaucratic and costly. With global markets opening as a result of a phenomenal increase in trade and travel, bartering for air rights on the terms of the most restrictive bilateral partner is increasingly out of step with the needs of the industry and the dynamics of the marketplace.

Multilateral negotiations would widen the scope of discussion, thereby providing an institutional means to aggregate gains and offset constraints more easily than in a series of bilaterals. Also, multilateral agreements could maximize overall efficiency by precluding larger countries or blocs from excluding the smaller countries from the benefits conferred by liberal bilateral agreements with other countries.

The liberal multilateral regime which the Think Tank advocates requires the opening of domestic markets to foreign competition and an acceptance of the possibility that nationally-owned airlines may be losers in the free market. This may be viewed as a revolutionary idea for the airline industry, but these conditions are accepted as the norm in many other industries in which transnational ownership has prevailed for many years.

Finally, it would be an unsatisfactory outcome if the creation of a liberal regime led to the elimination of competition, the reduction of effective choice and the domination of the industry by a powerful world-wide oligopoly. One of the basic requirements of a liberalized regime, therefore, must be the inclusion of effective competition rules and machinery with teeth for their enforcement.

Elements of a Liberal Multilateral

In order to ensure the regime that it advocates for implementation in the long run, the participants of the Think Tank believe that it should be the ultimate objective to incorporate the following fundamental principles into any liberal multilateral agreement:

Market Access: Within the area covered by the multilateral, any airline of a contracting state should be free to operate air services -- scheduled or charter -- between any points designated as international airports with no restriction on capacity or frequency of services. Any controls retained should be strictly related to technical or financial fitness considerations or to enhance the use of infrastructure. Moreover, rights on routes within contracting states (cabotage) should be included in this market access freedom, though this will become less important when ownership and establishment rights are liberalized.

Pricing: All controls over pricing should be eliminated, subject only to antitrust policies.

Competition/Antitrust Rules: Provisions must be included to prevent anti-competitive agreements, predatory practices or abuse of dominant position. They must provide for elimination of subsidies.

Doing Business Rules: Non-discriminatory rules and codes of conduct must be agreed for such matters as fair commercial opportunities, setting up sales and distribution outlets, access to computer reservation systems, fund transfers, taxation, charges, employment of expatriate staff, customs duties, ground handling, and other airport facilitation issues essential to airline operations.

Ownership and Rights of Establishment: Fundamental to the success of a freer trade regime for air transport is the abolition of the concept of "substantial ownership and effective control" by nationals of each state. The multilateral must allow ownership and control to be in the hands of nationals of any contracting state.

Accession: Membership of the multilateral should be open to any state willing and able to abide by the terms of the agreement.

How Do We Get There From Here?

The members of the Think Tank realize that transitional measures will be necessary to allow parties a reasonable period of adjustment to the financial, economic, philosophical and political realities of full liberalization in aviation. However, we urge that these measures be kept to a minimum.

We examined a number of approaches to achieving a multilateral agreement in aviation, including the use of the institutions of ICAO and GATT. It appears that for a number of reasons, both organizations carry too much baggage to be useful.

The best possibility for substantial liberalization in the near term is through arrangements between smaller groups of states with common aviation philosophies and market interests, open to

other states to join on the same terms. Indeed, moves towards regional liberalization agreements in Europe, North America and Australasia must be regarded as encouraging signs for multilateral liberalization.

Liberalized agreements of this kind may be seen by outside countries as potentially protectionist. In order to avoid this prospect, of course, the essence of any "expanding" multilateral must be that it cannot be exclusive: it must be open to accession by any country willing to accept its terms.

The critical need is for the liberalization of passenger services on a multilateral basis. However, the distinct economic and operational characteristics of all-cargo services, their already looser regulation, and the readily perceived benefits to trade, suggest that an all-cargo agreement might be a practical first step. The elimination of constraints and the consequential increase in the efficiency of cargo services would greatly benefit producers and customers throughout the world. And, not the least of considerations, all-cargo operators are, for the most part, seeking such liberalization in order to improve their competitive opportunities.

As you know, the U.S. Department of Transportation has been suggesting that such an agreement might be feasible and desirable for some time. In fact, in his testimony before this committee as recently as March 19, 1991, Mr. Jeffrey Shane, Assistant Secretary for Policy and International Affairs said:

"Our long term goals are to establish competitive multilateralism and multimodal regimes to replace the current bilateral approach to international aviation, ...we perceive that there may be possibilities of earlier results in the cargo sector. We are in the process of developing ideas for multilateral express freight agreement in markets where multilateral agreements might improve competitive opportunities for the U.S. transportation industry."

I applaud Mr. Shane's effort, trust that the effort will not be limited solely to the express sector of air freight, and hope that he and the Department will also emphasize the trade benefits to the economy, and specifically to U.S. communities, while they are developing their ideas. In addition, in view of the fact that the report of the Canadian House of Commons Special Committee on Canada - U.S. Air Transport Services specifically suggested that an open skies agreement in all-cargo might be desirable, I am very hopeful that the governments will pursue this idea on a fast track, rather than run the risk of having it bog down in the time frame and larger issues related to combination services. Such an agreement could conceivably provide the model for subsequent agreements with other countries.

An Action Plan

Obviously, governments must be convinced of the advantages of liberal multilateralism including all of its elements. Your hearings today are an encouraging move in the direction of providing a forum for the open debate of these ideas and principles. As stated before, we believe the trend toward liberalization is inevitable as trade and tourism markets expand, and governments loosen their grips on the ownership and regulatory control of air carriers.

The Think Tank is hoping that this process will move rapidly. We are doing all we can to encourage governments and industry to go through the windows of opportunity that will be presented in the coming months and years. In addition, we would like to see positive action taken toward convening working groups and conferences that will produce the first multilateral document and members for the agreement. This may be the U.S. and Canada, the U.S. and Central American, the U.S. and the EEC, or the EEC and Asia. Wherever it occurs, it can't be soon enough to accommodate the needs of the market and the interests of the consumer.

This concludes my prepared statement. I thank you for inviting me to appear before you today and would be happy to answer any questions that you might have.

